88-284

No....

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1987

DAIN BOSWORTH INCORPORATED,
Petitioner,

vs.

DAVID S. JOHNSON, KENNETH E. CARTER AND SHIRLEY R. CARTER,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF MINNESOTA

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August 12, 1988

1988 — Northwest Printing Co., 3010 2nd St. No., Minneapolis, MN 55411 — 588-7506

QUESTION PRESENTED

Does *Wilko v. Swan*, 346 U.S. 427 (1953), preclude enforcement of Respondents' concededly valid arbitration agreements with respect to claims under Section 12(2) of the Securities Act of 1933 in light of the Court's recent decision in *Shearson/American Express, Inc. v. McMahon*, — U.S. —, 107 S. Ct. 2332 (1987), and the 1975 amendments to the federal securities laws?

PARTIES TO THE PROCEEDINGS

Petitioner is Dain Bosworth Incorporated. Respondents are David S. Johnson, Kenneth E. Carter and Shirley R. Carter. Michael L. O'Brien is a defendant below, but is not represented by his own counsel and has not joined with Petitioner in submitting this Petition. Petitioner's parent company is Inter-Regional Financial Group, Inc. Petitioner's subsidiaries and affiliates are as follows:

Consolidated subsidiaries of Inter-Regional Financial Group, Inc.:

Dain Bosworth Incorporated
Dain Corporation
IFG Information Services, Inc.
IFG Leasing Company
Rauscher Pierce Refsnes, Inc.

Consolidated subsidiaries of Dain Bosworth Incorporated:

American Capital Resource, Inc.
Catalyst Energy Corporation
Dain Bosworth Consultants, Inc.
Dain Equity Partners, Inc.
Dain, Kalman & Quail Municipal-Nebraska, Inc.
Insight Bond Management Incorporated
Select Benefits, Inc.

Consolidated subsidaries of Dain Corporation:

Dain Management, Inc.
Dain Properties, Inc.

Consolidated subsidiaries of Rauscher Pierce Refsnes, Inc.:

Rauscher Pierce Corporation
Rauscher Pierce Refsnes Leasing, Inc.
RP Transportation Corp.
RPR Mortgage Finance Corporation
RPR Properties, Inc.
Trinity Research Corp.

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IN THE

Supreme Court of the United States

No. . . .

October Term, 1987

DAIN BOSWORTH INCORPORATED,
Petitioner,

vs.

DAVID S. JOHNSON, KENNETH E. CARTER AND SHIRLEY R. CARTER,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF MINNESOTA

Petitioner Dain Bosworth Incorporated ("Dain") respectfully petitions this Court to issue a writ of certiorari to review the order of the Minnesota Supreme Court denying review of the Minnesota Court of Appeals decision affirming the denial of Petitioner's motion to compel arbitration and stay proceedings brought pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* In a decision at odds with *Shearson/American Express, Inc. v. McMahon,* --- U.S. —, 107 S. Ct. 2332 (1987), the Minnesota Court of Appeals held that *Wilko v. Swan,* 346 U.S. 427 (1953), refused to enforce valid arbitration agreements with respect to claims under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2).

OPINIONS BELOW

The order and memorandum of the District Court for the Tenth Judicial District of the State of Minnesota is unpublished and is appended at A-11. The majority and dissenting opinions of the Minnesota Court of Appeals are reported at 420 N.W.2d 264 (Minn. App. 1988) and are appended at A-2. The Order of the Minnesota Supreme Court denying the petition for review is unpublished and is appended at A-1.

JURISDICTION

The Minnesota Supreme Court entered its order denying Dain's petition for review on May 18, 1988. This Petition was filed within ninety days of the entry of that order in accordance with 28 U.S.C. § 2101(c). Jurisdiction is based on 28 U.S.C. § 1257(3). *See Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975).

STATUTES INVOLVED

9 U.S.C. § 2 provides in pertinent part as follows:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3 provides as follows:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending.

upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceding with such arbitration.

9 U.S.C. § 4 provides in pertinent part as follows:

> . . . [U]pon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

15 U.S.C. § 771(2) provides in pertinent part as follows:

> Any person who —
>
> > (2) offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission) . . .
>
> shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 77n provides as follows:

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

STATEMENT OF THE CASE

This action arises out of financial losses from securities trading. Respondents allege that they purchased stock on margin in reliance on illegal "inside information" given them by Michael L. O'Brien that another company planned to acquire Kroy Incorporated ("Kroy"), and that the value of Kroy's stock was likely to increase substantially. Neither the acquisition nor the increase in stock value materialized; Kroy stock temporarily dropped in value. Respondents seek to hold Petitioner and Mr. O'Brien (a broker then employed by Petitioner) liable for losses claimed to be in excess of $300,000.

When Respondents opened their securities trading accounts with Petitioner, each executed a "Customer's Margin Agreement." Paragraph 10 of each agreement provides that any controversy arising out of the agreement or breach thereof "shall be settled by arbitration" in accordance with the rules of the New York Stock Exchange or of the American Arbitration Association. *See* Appendix at A-49. Notwithstanding their agreement to arbitrate all controversies, Respondents brought this state court action and thereafter refused Petitioner's demand that they voluntarily submit their claims to arbitration.

The history of Respondents' pleadings illustrates the lengths to which they have gone to avoid enforcement of their agreement to arbitrate this controversy. The original

Complaint (appended at A-15) alleged claims under the Minnesota Securities Act, Minn. Stat. § 80A.01 *et seq.* After that Complaint was served, the Minnesota Supreme Court decided *Fairview Cemetery Assoc. v. Eckberg,* 385 N.W.2d 812 (Minn. 1986), which reversed precedent and held that claims under the Minnesota Securities Act were arbitrable. As a result, Respondents amended their Complaint to add a claim under Section 12(2) of the Securities Act of 1933. (The First Amended Complaint is appended at A-27.) Petitioner's counsel then brought to the attention of Respondents' counsel this Court's decision in *Dean Witter Reynolds Inc. v. Byrd,* 470 U.S. 213 (1985), holding that arbitrable claims must be submitted to arbitration even when intertwined with nonarbitrable claims. Petitioner's counsel also informed Respondents' counsel of other decisions staying proceedings on federal law claims pending the arbitration of state law claims. Shortly thereafter, Respondents again amended their Complaint, this time deleting their claim under the Minnesota Securities Act and leaving as their sole claim that under Section 12(2). (The Second Amended Complaint is appended at A-40.)

In response to the Second Amended Complaint, Petitioner moved pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, for an order compelling arbitration and staying proceedings. Petitioner relied primarily on this Court's decision in *Shearson/American Express, Inc. v. McMahon,* — U.S. —, 107 S. Ct. 2332 (1987), and the 1975 amendments to the federal securities laws. The district court denied the motion. Petitioner subsequently filed a timely appeal to the Minnesota Court of Appeals pursuant to Minn. Stat. § 572.26 (which provides for immediate appeal of any order denying a motion to compel arbitration). In a sharply

divided decision comprising three separate opinions, the Court of Appeals affirmed. 420 N.W.2d 264 (Minn. App. 1988); Appendix at A-2. Petitioner timely sought discretionary review of that decision before the Minnesota Supreme Court pursuant to Rule 117 of the Minnesota Rules of Civil Appellate Procedure. On May 18, 1988, that court denied review. Appendix at A-1.

At no time have Respondents contended, nor has any court found, that their agreement to arbitrate was obtained by fraud or is unconscionable. Indeed, Respondents have never raised any challenge to the validity of their agreements. Instead, they have based their refusal to arbitrate solely on the contention that their otherwise valid arbitration agreements cannot be enforced as to Section 12(2) claims because of *Wilko v. Swan*, 346 U.S. 427 (1953).

REASONS FOR GRANTING THE WRIT

The Minnesota Courts Incorrectly Decided An Important And Recurring Question Of Federal Law Which Should Be Settled By This Court

The arbitrability of claims under the 1933 Act has been a subject frequently and hotly disputed in the year since this Court decided *Shearson/American Express, Inc. v. McMahon*. Despite the clear statement in *McMahon* that the rationale underlying *Wilko v. Swan* no longer obtains, several lower courts (including the Minnesota Court of Appeals) have erroneously concluded that *Wilko* nevertheless continues to govern Section 12(2) claims. These decisions misapprehend the effect of *McMahon*, frustrate the undisputed federal policy favoring arbitration, and create an uncertainty which has a deleterious effect on the contractual relations between securities investors and brokerage

firms. In denying Petitioner's request for review, the Minnesota Supreme Court has let such a decision stand. That ruling is at odds not only with *McMahon*, but with the clear trend which has developed in recent lower federal court decisions on this issue. Accordingly, so that it may make unequivocally clear that valid arbitration agreements must be enforced as to all federal securities law claims, including those under Section 12(2), and may settle the conflict among the lower courts on this issue, this Court should grant the petition for a writ of certiorari.

I.

The Minnesota Supreme Court Let Stand a Decision Which Incorrectly Applied the Rule of *McMahon*

In recent years this Court has repeatedly and decidedly ruled in favor of enforcing valid agreements to arbitrate. *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985); *Southland Corp. v. Keating*, 465 U.S. 1 (1984). In *Shearson/American Express, Inc. v. McMahon*, — U.S. —, 107 S. Ct. 2332 (1987), the most recent of these decisions, the Court continued that trend by holding that predispute arbitration agreements must be enforced as to claims under the Securities Exchange Act of 1934. In reaching this conclusion, the Court rejected the invitation (already accepted by most lower courts) to extend *Wilko v. Swan* to the 1934 Act. Instead, this Court characterized its own thirty-five-year-old decision in *Wilko v. Swan* as based on a mistrust for arbitration which no longer had any basis in fact:

> . . . [T]he mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with

> the assessment of arbitration that has prevailed since that time. This is especially so in light of the intervening changes in the regulatory structure of the securities law. Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC's oversight authority.

— U.S. at —, 107 S. Ct. at 2341. In other words, the *McMahon* Court rejected *Wilko*'s 1953 reasoning because of the changed reality of 1987, together with the far-reaching legislative and regulatory changes in the federal securities laws enacted twenty-two years after *Wilko* was decided.[1]

The Court did not base its reasoning on differences between the 1933 Act and the 1934 Act. Indeed, although those differences were extensively briefed, this Court dismissed them as the basis for its decision. — U.S. at —, 107 S. Ct. at 2339. Instead, the Court based its decision primarily on the presence of oversight authority vested in the SEC —oversight authority which exists by virtue of Congress' 1975 amendments to the federal securities laws, 15 U.S.C.

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[1]The *Wilko* court construed the securities laws as they existed in 1953. In 1975 Congress amended a highly relevant provision of those laws and empowered the SEC to remedy precisely the deficiencies that the *Wilko* court, rightly or wrongly, had perceived in the arbitration procedures available in 1953. *See* 15 U.S.C. § 78s. Indeed, it was precisely this change that impelled the SEC to reverse its longstanding position opposing arbitration of federal securities law claims and to advocate routine enforcement of arbitration agreements as to all securities claims. The statutory framework before this Court therefore is fundamentally different from that construed in *Wilko*. The SEC now has regulatory authority to ensure that arbitration procedures are adequate to protect statutory rights, including those under Section 12(2). *See McMahon*, — U.S. at —, 107 S. Ct. at 2341.

§ 78s, and which did not exist when *Wilko* was decided.[2] It found that arbitration today, as subject to the rules and oversight of the SEC, was adequate to protect the rights of securities investors.

Since *McMahon* has already held arbitration adequate to protect investors' rights, *Wilko*'s rationale has been undermined and no longer governs this case. As a result of the passage of time and new legislation, *Wilko*'s *raison d'etre* no longer exists. In affirming the denial of Petitioner's motion to compel arbitration, however, the Minnesota Court of Appeals erroneously concluded that until overruled, *Wilko* continues to govern this issue. *See* Appendix at A-—. The Court of Appeals failed to recognize that in *McMahon,* by confining *Wilko* to its facts (arbitration and the statutory framework as they existed in 1953), this Court has already effectively rendered *Wilko* inapplicable to current issues of arbitrability, *Wilko*'s reasoning no longer applies because of the changed nature of arbitration. Simply put, there is no need to overrule *Wilko* to hold the decision below erroneous.

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[2]Indeed, the SEC recently rescinded the rule which reflected its opposition to arbitration of federal securities law claims. Rule 15c2-2, 17 C.F.R. §240.15c2-2. In so doing, it stated:

> On June 8, 1987, the Supreme Court held in *Shearson/American Express v. McMahon* that predispute agreements to arbitrate claims arising under the Securities Exchange Act of 1934 are enforceable. In addition, although the Court did not expressly overrule *Wilko v. Swan,* which held that predispute agreements to arbitrate claims arising under Section 12(2) of the Securities Act of 1933 were not enforceable, the Court's reasoning raised questions regarding the continuing vitality of that decision. In light of these developments, the Commission believes that Rule 15c2-2 is no longer appropriate or accurate and, accordingly, should be rescinded.

Exchange Act Release No. 25034, reported in 1987 Fed. Sec. L. Rptr. (CCH) ¶ 84,163 at 88,887 (October 15, 1987). The SEC now supports the enforcement of arbitration agreements under both 1934 and the 1933 Acts.

II.

The Arbitrability Of Claims Under Section 12(2) Is An Important And Recurring Question Which Has Resulted In Conflict Among The Lower Courts And Which Should Be Settled By This Court

In the wake of *McMahon*, the question whether Section 12(2) claims are arbitrable has divided lower courts, both state and federal, throughout the nation. Shortly after *McMahon* was announced, several courts found that it had no impact on pending motions to compel arbitration of Section 12(2) claims. *See, e.g., Chang v. Lin*, 824 F.2d 219, 222 (2d Cir. 1987) (noting, in *dictum*, that *McMahon* did not overrule *Wilko*); *McCowan v. Dean Witter Reynolds Inc.*, 682 F. Supp. 741, 744 (S.D.N.Y. 1987) (same); *Continental Service Life & Health Insur. Co. v. A.G. Edwards & Sons, Inc.*, 664 F. Supp. 997, 1001 (M.D. La. 1987) (same). More recently, however, the clear trend is toward finding claims under Section 12(2) to be arbitrable. *See, e.g., Rodriguez De Quijas v. Shearson/Lehman Brothers, Inc.*, 845 F.2d 1296 (5th Cir. 1988) (finding that the reasoning of *McMahon* "completely undermines" *Wilko* and that Section 12(2) claims must be arbitrated under valid arbitration agreements);[3] *Noble v. Drexel Burnham Lambert, Inc.*, 823 F.2d 849, 850 n.3 (5th Cir. 1987) ("*McMahon* undercuts every aspect of *Wilko v. Swan* . . . a formal overruling of *Wilko* appears inevitable—or, perhaps, superfluous"); *Adams v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 1988 Fed. Sec. L. Rptr. (CCH) ¶

[3]Petitioner understands that plaintiffs in *Rodriguez* may file a petition for writ of certiorari asking this Court to review, and reverse as erroneous, the Fifth Circuit's decision ordering arbitration of their Section 12(2) claims.

93,741, at 98,478 (W.D. Okla. 1988) (*Wilko* no longer imposes blanket prohibition against arbitration); *Aronson v. Dean Witter Reynolds Inc.*, 675 F. Supp. 1324, 1325 (S.D. Fla. 1987) ("*McMahon* decision so eroded *Wilko*'s rationale that [Section 12(2)] claims should be sent to arbitration"); *Staiman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 673 F. Supp. 1009, 1011 (C.D. Cal. 1987) (same).[4]

The end result of the conflict among the lower courts is a patchwork of answers to a question which requires nationwide uniformity. As it stands now, despite this Court's ruling in *McMahon*, there is discord rather than harmony. The result suggested by the Minnesota Court of Appeals decision—that the state of the law is that parties *can* be required to arbitrate claims under the 1934 Act (*McMahon*), but *cannot* be required to arbitrate claims under the 1933 Act (*Wilko*)—is illogical and intolerable. This Court should resolve the conflict among the lower courts, and the conflict they have created between the 1933 and 1934 Acts, by making clear that *Wilko* no longer precludes arbitration of claims under the 1933 Act. This may be done either by limiting *Wilko*'s application in light of *McMahon* and the 1975 amendments to the federal securities laws, or by overruling *Wilko*. In either event, this Court needs to act on the issue.

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[4]For similar reasons, several courts have ordered arbitration of claims under Section 17(a) of the 1933 Act. *See, e.g., Ryan v. Liss, Tenner & Goldberg Securities Corp.*, 683 F. Supp. 480, 484 (D.N.J. 1988); *Kavouras v. Visual Products Systems, Inc.*, 680 F. Supp. 205, 207-08 (W.D. Pa. 1988); *Rocz v. Drexel Burnham Lambert, Inc.*, 154 Ariz. 462, 743 P.2d 971 (1987).

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Dated: August 12, 1988

Respectfully submitted,

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APPENDIX

APPENDIX

STATE OF MINNESOTA
IN SUPREME COURT
C9-87-1784

David S. Johnson, et al.,

Respondents,

vs.

Michael L. O'Brien,

Defendant,

Dain Bosworth Incorporated,

Appellant.

ORDER

Based upon all the files, records and proceedings herein, IT IS HEREBY ORDERED that the petition of Dain Bosworth Incorporated for further review be, and the same is, denied.

Dated: 5-18-88

BY THE COURT:

/s/ DOUGLAS K. AMDAHL
Chief Justice

Office of
Appellate Courts
May 18, 1988
FILED

POPOVICH, J. took no part.

STATE OF MINNESOTA
IN COURT OF APPEALS
C9-87-1784

Washington County

Nierengarten, Judge
Dissenting, Forsberg, Judge
Concurring Specially,
Crippen, Judge

David S. Johnson, et al.,

Respondents,

Edward Lynch
Thuet, Lynch, Pugh & Rogosheske
833 Southview Boulevard
South St. Paul, MN 55075

vs.

Michael L. O'Brien,

Defendant,

Dain Bosworth, Incorporated,

Appellant.

Edward J. Pluimer
James K. Langdon. II
Dorsey & Whitney
2200 First Bank Place West
Minneapolis, MN 55402
Filed: March 15, 1988
Office of Appellate Courts

SYLLABUS

The district court did not err by denying a motion for an order compelling arbitration of the respondents' claims under section 12(2) of the Securities Act of 1933. The parties' predispute arbitration agreement is not enforceable under *Wilko v. Swan*, 346 U.S. 427 (1953).

Affirmed.

Heard, considered and decided by Forsberg, Presiding Judge, Nierengarten, Judge and Crippen, Judge.

OPINION

NIERENGARTEN, Judge

This is an appeal from an order denying the appellant's motion to compel arbitration and stay judicial proceedings. The appellant contends the respondents' claims under federal securities law are subject to arbitration under a provision in its customer margin agreements. We affirm.

FACTS

On the advice of Michael O'Brien, an employee of appellant Dain Bosworth Incorporated (Dain Bosworth), respondents David Johnson, Kenneth Carter and Shirley Carter purchased stock in Kroy Incorporated. The respondents contend O'Brien told them another company intended to acquire Kroy and that the value of Kroy stock would increase substantially. The acquisition did not occur and the value of Kroy stock did not increase. The stock temporarily decreased in value and the respondents incurred losses.

The respondents sued Dain Bosworth claiming Dain Bosworth violated section 12(2) of the Securities Act of 1933 and was liable for the losses they incurred by trading

on the allegedly illegal "inside information." Dain Bosworth attempted to arbitrate the claims according to a provision in its customer margin agreements with the respondents which provide that any controversy between the respondents and Dain Bosworth "shall be settled by arbitration" in accordance with the rules of the New York Stock Exchange or the American Arbitration Association. When the respondents refused to submit their claims to arbitration, Dain Bosworth moved the district court for an order compelling arbitration.

The district court denied Dain Bosworth's motion to compel arbitration because the court concluded *Wilko v. Swan*, 346 U.S. 427 (1953), precludes enforcement of predispute arbitration agreements when claims are predicated on section 12(2) violations. Dain Bosworth appeals under Minn. R. Civ. App. P. 103.03(e) and Minn. Stat. § 576.26, subd. 1(1) (1986).

ISSUE

Did the district court err by denying the appellant's motion for an order compelling arbitration?

ANALYSIS

The respondents allege their losses were caused by their reliance on O'Brien's misrepresentations and use of inside information, and consequently claim Dain Bosworth is liable for their losses under section 12(2) of the Securities Act of 1933.

> Any person who —
>
> * * * *
>
> (2) offers or sells a security * * * by the use of any means or instruments of transportation or

> communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), * * *
>
> shall be liable to the person purchasing such security from him, *who may sue either at law or in equity in any court of competent jurisdiction,* to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C.A. § 771 (West 1981) (codification of section 12(2) of the Securities Act of 1933) (emphasis added). Section 14 of the 1933 Act states that compliance with the provisions of the act may not be waived.

> Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

15 U.S.C.A. § 77n (West 1981) (codification of section 14 of the Securities Act of 1933).

The Federal Arbitration Act states that arbitration agreements "shall be valid, irrevocable, and enforceable," except "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C.A. § 2 (West 1970).

Provided an arbitration agreement is within the purview of the Arbitration Act, the Act "establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983). However, in *Wilko v. Swan*, 346 U.S. 427 (1953), the Supreme Court held that predispute arbitration agreements are not enforceable if the claims arise under section 12(2) of the Securities Act of 1933.

According to the Supreme Court, the Securities Act of 1933 established a buyer's "special right" to recover for misrepresentations which is "enforceable in any court of competent jurisdiction." *See Wilko*, 346 U.S. at 431. Notwithstanding the Arbitration Act, the Court concluded the parties' predispute arbitration agreement was a "stipuation" and that "the right to select the judicial forum is the kind of 'provision' that cannot be waived under § 14 of the Securities Act." *See id.* at 434-35.

The Court opined "that the Securities Act was drafted with an eye to the disadvantages under which [securities] buyers labor," and concluded it was reasonable for Congress to place securities buyers covered by the Act on a different basis from other purchasers. *See id.* at 435. The Court noted that the effectiveness of the advantages conferred by the Securities Act "is lessened in arbitration as compared to judicial proceedings" and that arbitration proceedings were not particularly well suited to making "subjective findings on the purpose and knowledge of an alleged violator of the Act." *Id.* at 435-36. The *Wilko* decision was based in large part on the Court's general distrust of arbitration.

The rationale of the *Wilko* decision and its holding about the enforceability of predispute arbitration agreements recently were questioned by the Supreme Court in *Shearson/American Express, Inc. v. McMahon,* — U.S. —, 107 S. Ct. 2332 (1987). The plaintiffs in *McMahon* signed customer agreements with a brokerage firm which provided for arbitration of any controversy arising out of or relating to their accounts. The plaintiffs sued the brokerage firm alleging the firm violated section 10(b) of the Securities Exchange Act of 1934 by engaging in fraudulent and excessive trading on their accounts, and by making false statements and omitting material facts from investment advice. Section 10(b) is similar to section 12(2) of the Securities Act of 1933 and the Exchange Act of 1934 contains a similar anti-waiver provision which invalidates contract provisions waiving compliance with any provision of the Act. *See* 15 U.S.C.A. §§ 78j(b), 78cc(a) (West 1981).

The *McMahon* Court noted that the Exchange Act conferred exclusive jurisdiction over violations with the district courts, but concluded the anti-waiver provision of the Act did not preclude waiver of judicial proceedings because the provision "only prohibits waiver of the substantive obligations imposed by the Exchange Act." *McMahon,* 107 S. Ct. at 2338. Accordingly, the Court concluded claims under section 10(b) of the Exchange Act of 1934 are arbitrable. *See id.* at 2343. The Court noted that *Wilko* involved claims under section 12(2) of the Securities Act of 1933 and questioned the rationale of the *Wilko* decision which was based on the Court's general "mistrust of arbitration." *See id.* at 2340-41. However, despite its apparent misgivings about the continuing validity of the rationale underlying its *Wilko* decision, the *McMahon* Court did not overrule *Wilko.*

> * * * * While *stare decisis* concerns may counsel against upsetting *Wilko's* contrary conclusion under the Securities Act, we refuse to extend *Wilko's* reasoning to the Exchange Act in light of these intervening regulatory developments.

Id. at 2341.

The continuing validity of the *Wilko* decision is questionable. *See, e.g., Staiman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 673 F. Supp. 1009, 1011 (C.D.Ca. 1987) (the federal district court concluded "*McMahon* so seriously undermined *Wilko's* rationale that [the investor's] 1933 Act claims, like his other claims, must be sent to arbitration"). However, the district court did not err by denying Dain Bosworth's motion to compel arbitration. The respondents assert claims only under section 12(2) of the Securities Act of 1933 and do not allege any section 10(b) violations. *McMahon* addressed section 10(b) claims and the enforceability of predispute arbitration agreements within the context of the Exchange Act of 1934; it did not rule on the arbitrability of claims under section 12(2) of the 1933 Act. Until *Wilko* is overruled, we are compelled to apply the Supreme Court's prevailing precedents with respect to predispute arbitration agreements and federal securities law. *See Thurston Motor Lines, Inc. v. Jordon K. Rand, Ltd.*, 460 U.S. 533, 535 (1983) ("Needless to say, only this [the Supreme] Court may overrule one of its precedents."); *see also Chang v. Lin*, 824 F.2d 219, 222 (2d Cir 1987) ("Although the Supreme Court in *McMahon* questioned the rationale underlying *Wilko*, the Court nevertheless did not overrule that decision, and it continues to govern us."); *Schultz v. Robinson-Humphrey/American Express, Inc.*,

666 F. Supp. 219, 220 (M.D. Ga. 1987) (the federal district court concluded "the Supreme Court did not overrule *Wilko*, and has implicitly reaffirmed the nonarbitrable nature of Section 12 claims").

DECISION

The district court did not err by denying the appellant's motion for an order compelling arbitration of the respondents' claims under section 12(2) of the Securities Act of 1933. The parties' predispute arbitration agreement is not enforceable under *Wilko v. Swan*, 346 U.S. 427 (1953).

Affirmed.

R.J.N.
3/7/88

FORSBERG, Judge (Dissenting):

I respectfully dissent. *Wilko v. Swan*, 346 U.S. 427 (1953), has been narrowly limited to its facts by *Shearson/American Express, Inc. v. McMahon*, — U.S. —, 107 S. Ct. 2332 (1987). *Wilko* now stands *only* for the proposition that "*where* arbitration is inadequate to protect the substantive rights at issue," then and only then is waiver of a judicial hearing barred. *McMahon*, 107 S. Ct. at 2339.

This is not the case here, and the overwhelming policy favoring arbitration should be upheld.

March 8, 1988

Thomas G. Forsberg

CRIPPEN, Judge, concurring specially

Section 12(2) of the Security Act of 1933 expressly declares the seller's liability to the buyer in a case where

the seller employs untrue or incomplete statements to sell securities. 15 U.S.C.A. § 771 (West 1981). Even more specifically, the section declares that the seller's liability may be established by suit in any court of competent jurisdiction. Examining the language of these provisions, together with the later enactment by Congress of the United States Arbitration Act (9 U.S.C.A. § 1 et seq. [West 1980]), the United States Supreme Court decided that the "intention of Congress" in the Securities Act was better carried out by holding invalid an agreement for arbitration instead of judicial proceedings to determine section 12(2) liability. *Wilko v. Swan*, 346 U.S. 427 (1953). Appellant's suggestion that this court disregard the holding in *Wilko* is unacceptable. There are reasons for this conclusion in addition to those noted in the majority opinion.

First, *Wilko* determined the intention of Congress in 1933. Subsequent abandonment of judicial views expressed in *Wilko* does not alter the intention of Congress in 1933. Congress itself has said nothing constituting an amendment of its 1933 enactment, even though *Wilko* was decided thirty-five years ago. It is by no means certain that *Wilko* will ever be overruled by the Supreme Court in the absence of legislative alteration of section 12(2).

In addition, section 12(2) of the Securities Act is unique, when compared with the provisions of the Exchange Act of 1934 reviewed in *Shearson/American Express, Inc. v. McMahon*, — U.S. —, 107 S. Ct. 2332 (1987). Section 10(b) of the Securities Exchange Act of 1934 describes unlawful acts and it is silent on the question of remedies for those acts. 15 U.S.C.A. § 78j(b) (West 1981). In contrast, section 12(2) of the 1933 enactment is an express declaration of civil liability in judicial proceedings. The

Wilko determination that arbitration was an inappropriate substitute for the remedy declared in the 1933 Act is wholly understandable. It is equally understandable that the Supreme Court in *McMahon* deliberately backed away from overruling *Wilko*. *See McMahon*, — U.S. at —, 107 S. Ct. at 2338 (It "must be understood" that *Wilko* found the buyer's waiver of judicial forum unenforceable "because arbitration was judged inadequate to enforce the statutory rights created by § 12(2)").

March 8, 1988

Gary L. Crippen

STATE OF MINNESOTA — DISTRICT COURT
County of Washington — Tenth Judicial District

David S. Johnson, Kenneth E. Carter and Shirley R. Carter,
Plaintiffs,

vs.

Michael L. O'Brien and Dain Bosworth Incorporated,
Defendants.

ORDER
File No. C8-87-2100

The above-entitled matter came on for hearing before the undersigned on August 21, 1987, at the Washington County Government Center, Stillwater, Minnesota, pursuant to the Motion of Defendant Dain Bosworth Incorporated for an Order compelling arbitration of the Plaintiffs' claims herein.

Edward Lynch, Esq., and Paul W. Rogosheske, Esq., appeared on behalf of the Plaintiffs. James K. Langdon,

Esq., appeared on behalf of Defendant Dain Bosworth Incorporated.

Based upon all of the files, records and proceedings herein, including the arguments of counsel and written memoranda submitted,

IT IS HEREBY ORDERED:

ORDER

1. That the Motion of Defendant Dain Bosworth Incorporated for an Order compelling arbitration of the Plaintiffs' claims herein is hereby DENIED.

2. That the Washington County Court Administrator shall serve a true and correct copy of this Order by U.S. mail upon the above-named counsel which shall constitute due and proper service of this Order for all purposes.

The attached Memorandum is made a part hereof by reference.

Dated: August 28th, 1987

Judge of District Court
/s/ KENNETH J. MAAS

MEMORANDUM

Re: *David S. Johnson, et al. v. Michael L. O'Brien and Dain Bosworth Incorporated* — File No. C8-87-2100

Defendant Dain Bosworth Incorporated (hereinafter "Defendant") seeks to compel arbitration of the Plaintiffs' claims herein pursuant to a clause contained in the "Customers Margin Agreement" executed by each of the Plaintiffs when they opened their accounts with the Defendant. Said clause provides that any controversy arising out of

the Agreement or a breach thereof "shall be settled by arbitration". The Defendant has demanded that the Plaintiffs' claims be submitted to arbitration pursuant to the arbitration clause contained in the parties' Agreements, but the Plaintiffs have failed and refused to voluntarily submit their claims to arbitration. Hence, the matter of the enforceability of the arbitration clause has been brought before this Court.

The Plaintiffs' claim against the Defendant is solely based upon the assertion that the Defendant's conduct violated §12(2) of the Securities Act of 1933 (15 U.S.C. §771(2)). The Plaintiffs assert that the Defendant and Michael L. O'Brien made false statements of material fact and improperly used "inside information" in soliciting the Plaintiffs to make certain stock purchases ultimately causing the Plaintiffs to incur substantial monetary losses.

As cited by both parties, the general rule for more than 30 years has been that arbitration clauses are unenforceable for controversies arising out of the Securities Act of 1933. *Wilko v. Swan*, 346 U.S. 427 (1953). At the same time, it is true that in the past the Supreme Court has suggested that the *Wilko* decision is not applicable to cases arising out of §10(b) of the Securities Exchange Act of 1934. See, e.g., *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985); *Scherk v. Alberto-Culver Company*, 417 U.S. 506 (1974). The Defendant contends that the action of the Supreme Court evidences a trend toward the erosion of the non-arbitration rule set down in *Wilko*.

Now, the Defendant cites the recent United States Supreme Court decision in *Shearson/American Express, Inc. v. McMahon*, — U.S. —, 107 S.Ct. 2332 (1987), for the proposition that the *Wilko* decision has been effectively

overruled, or at a minimum, rendered ineffectual in this instance. In *McMahon*, the Supreme Court held that claims arising under §10(b) of the Securities Exchange Act of 1934 were arbitrable under predispute arbitration agreements.

Although this Court may agree that the *McMahon* decision clearly answers the question of the applicability of the *Wilko* rule and actions under the 1934 Act, one must remember that the action herein has been brought under the 1933 Act. The *McMahon* court specifically and clearly stated that it was not overruling the *Wilko* rule: "while *stare decisis* concerns may counsel against upsetting *Wilko's* contrary conclusion under the [1933 Act], we refuse to extend *Wilko's* reasoning to the [1934 Act] in light of these intervening regulatory developments". U.S. at —, 107 S.Ct. at 2341.

Therefore, with the *Wilko* rule seemingly intact after *McMahon* as to actions arising under the 1933 Act, this Court is most reluctant to sidestep long-held precedence. Although the Defendant argues that *Wilko* was "effectively" overruled by *McMahon*, this Court does not come away with such a far-reaching interpretation. This Court's decision will be bound, as it must, by controlling language from a higher court. Defendant's Motion to compel arbitration has, therefore, been denied.

K. J. M.

STATE OF MINNESOTA
County of Washington

DISTRICT COURT
Tenth Judicial District

David S. Johnson, Kenneth E. Carter, Shirley R. Carter, James Reier, Roger Ruetten and Margaret Ruetten,
Plaintiffs,

vs.

Michael L. O'Brien and Dain Bosworth, Incorporated,
Defendants.

SUMMONS

THE STATE OF MINNESOTA TO THE ABOVE-NAMED DEFENDANTS:

You are hereby summoned and required to serve upon Plaintiffs' attorneys an Answer to the Complaint which is herewith served upon you within twenty (20) days after service of this Summons upon you, exclusive of the day of service. If you fail to do so, judgment by default will be taken against you for the relief prayed for in the Complaint.

THUET, LYNCH, PUGH & ROGOSHESKE
/s/ Paul W. Rogosheske
Atty. Reg. No. 92861
Attorney for Plaintiff
833 Southview Blvd.
South St. Paul, MN 55075
451-6411

(Title of Cause)

COMPLAINT

Plaintiffs, as and for their Complaint against Defendants, state and allege:

GENERAL ALLEGATIONS

1. At all times material hereto, Plaintiffs, David S. Johnson (Johnson), James Reier (Reier), Roger Ruetten and Margaret Ruetten (Ruettens) have been residents of Washington County, Minnesota, and Plaintiffs, Kenneth E. Carter and Shirley R. Carter (Carters), have been residents of the State of Colorado.

2. Defendant, Dain Bosworth, Incorporated (Dain Bosworth) is a broker dealer registered with the U.S. Securities and Exchange Commission under Section 15(b) of the Securities Exchange Act of 1934, 15 USC §78o(b) (1985), and licensed by the Minnesota Commissioner of Commerce under Minn. Stat. 80.04, Subd. 1.

3. At all times material hereto, Defendant, Michael L. O'Brien (O'Brien), was a registered representative under the United States Securities Exchange Act of 1934 and a licensed agent under Minn. Stat. 80A.04, Subd. 1, and employed by Defendant, Dain Bosworth, as its agent.

4. Defendants are subject to the provisions of Minn. Stat. 80.01, et. seq.

5. At all times material hereto, Defendants acted as "market maker" of Kroy Incorporated (Kroy) stock as defined in §3(a)38 of the U.S. Securities Exchange Act of 1934, 15 USC §78c(a)(38)(1985).

ALLEGATIONS REGARDING PLAINTIFF JOHNSON

6. Paragraphs 1 through 5 are realleged.

7. Between October 9, 1984 and March of 1985, Defendants solicited Johnson to buy certain shares of common stock of Kroy.

8. Defendants made untrue statements of material facts in the solicitation of Johnson, including, but not limited to, the following:

(a) That Defendant O'Brien had "inside information" that Kroy was to be acquired by 3M Co. at a price of $21.00 per share, and that this acquisition could be part stock and part cash depending on the price of 3M stock. In any event, the acquisition would increase the value of the Kroy stock to at least $21.00 per share.

(b) That the "inside information" came from William Clapp, a member of the Board of Directors of Kroy who indicated that a purchase of Kroy stock at less than $15.00 a share would be profitable.

(c) That the investment had no "downside risks" and was a "sure thing."

(d) That in the event the acquisition of Kroy by 3M Company failed to be consummated, two other companies, Hallmark Inc. and a West German company, were each eager to acquire Kroy and such acquisition would greatly increase the value of Kroy common stock.

9. Said representations contained in paragraph 8 were made repeatedly to induce Johnson to invest repeatedly in Kroy stock, and they did in fact induce Johnson to do so, as herein alleged.

10. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

11. At the time of said solicitation, Johnson was not aware that the Defendants' representations were false and misleading, and relying upon said representations, Johnson entered into various contracts with Defendants for the ultimate purchase from them of 17,000 shares of common stock of Kroy at an average purchase price of $12.31 per share. Were it not for the Defendants' misrepresentations, Johnson would not have purchased said shares of stock.

12. Johnson purchased the shares of Kroy stock on a margin account maintained with Dain Bosworth. Interest was charged Johnson by Dain Bosworth in connection with said margin account in addition to profits made by defendants on each individual sale.

13. All of Defendants' representations contained in paragraph 8 turned out to be false, and the value of the Kroy stock dropped to an average of $7.00 per share, at which price Johnson sold 6,000 shares of Kroy stock.

14. Defendants' actions alleged herein constituted untrue statements of material facts and a practice or course of business which operated as a fraud or deceit upon Johnson, in connection with the purchase or sale of a security, in violation of Minn. Stat. 80A.01(b) and (c)(1984).

15. As a direct consequence of Defendants' actions, Johnson sustained damages in the amount of $31,860.00 on the sale of 6,000 shares, together with interest.

16. Johnson hereby tenders to the Defendants the 11,000 shares of Kroy stock still held by him and demands the return of $135,410.00 paid for these shares, together with interest.

ALLEGATIONS REGARDING PLAINTIFF CARTER

17. Paragraphs 1 through 5 are realleged.

18. Between October 5, 1984 and March of 1985, Defendants solicited Kenneth E. Carter to buy certain shares of common stock of Kroy.

19. Defendants made untrue statements of material facts, including, but not limited to, the following:

(a) That Defendant O'Brien had information from a director of Kroy that Kroy was to be acquired by 3M Company within two months.

(b) That any purchase of Kroy stock at less than $15.00 per share would be profitable as a result of the acquisition.

(c) That in the event the acquisition of Kroy by 3M Company was not consummated, two other substantial enterprises were eager to acquire Kroy and any such acquisition would greatly increase the value of Kroy common stock.

(d) That negotiations for the acquisition of Kroy by 3M Company were progressing smoothly and that the announcement of the acquisition was imminent.

20. The representations by Defendants to Kenneth E. Carter contained in paragraph 19 were made repeatedly to induce Kenneth E. Carter to invest repeatedly in Kroy stock, and they did in fact induce Kenneth E. Carter to do so, as herein alleged.

21. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

22. At the time of said solicitation, Kenneth E. Carter was not aware that Defendants' representations were false and misleading, and relying upon said representations, Kenneth E. Carter entered into various contracts with Defendants for the ultimate purchase from them of 41,000 shares of common stock of Kroy at an average price of $13.18 per share. Were it not for the misrepresentations of O'Brien, Kenneth E. Carter would not have purchased said shares of stock.

23. Kenneth E. Carter purchased the shares of Kroy stock on a margin account maintained with Defendants and transferred the shares to his wife, Shirley R. Carter, on April 24, 1985. Carters were charged interest by Defendants in connection with said margin account in addition to the profits made by Defendants on each individual sale.

24. All of Defendants' representations contained in paragraph 19 turned out to be false, and the value of the Kroy stock dropped to $9.00 per share by the date of commencement of this action.

25. Defendants' actions alleged herein constituted untrue statements of material facts and a practice or course of business which operated as a fraud or deceit upon Carters,

in connection with a purchase or sale of a security, in violation of Minn. Stat. 80A.01(b) and (c)(1984).

26. Carters hereby tender to the Defendants the 41,000 shares of Kroy stock held by them and demand the return of $540,380.00 paid for these shares, together with interest.

27. Carters have demanded payment to them by Defendants of the amount paid for the stock, a total of $540,215.25, together with interest, but Defendants have failed and refused to return any of the monies paid for the stock.

ALLEGATIONS REGARDING PLAINTIFF REIER

28. Paragraphs 1 through 5 are realleged.

29. Between October 9, 1985 and March of 1986, Defendants solicited Reier to buy certain shares of common stock of Kroy.

30. Defendants made untrue statements of material facts in the solicitation of Reier, including, but not limited to, the following:

(a) That Defendant O'Brien had "inside information" that Kroy was to be acquired by 3M Co. at a price in the high teens or low twenties per share, and that this acquisition would increase the value of the Kroy stock to at least in the high teens or low twenties per share.

(b) That the investment had no "downside risks" and was a "sure thing."

(c) That Defendant O'Brien would "bird dog" the stock to ensure no risk at all to Reier.

31. Defendants omitted to state material facts in the solicitation of Reier to purchase Kroy stock, including, but not limited to, the following:

(a) Defendants did not explain that Defendants were "market makers" in Kroy.

(b) Defendants placed Reier on a margin account without an adequate explanation of said account, knowing Reier was an unsophisticated investor.

32. Said representations contained in paragraph 30 and the omissions contained in paragraph 31 were made repeatedly to induce Reier to invest in Kroy stock, and they did in fact induce Reier to do so, as herein alleged.

33. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

34. At the time of said solicitation, Reier was not aware that the Defendants' representations were false and misleading, and relying upon said representations, Reier entered into a contract with Defendants for the purchase from them of 1,350 shares of common stock of Kroy at an average purchase price of $12.00 per share. Were it not for the misrepresentations of O'Brien, Reier would not have purchased said shares of stock.

35. Reier purchased some of the shares of Kroy stock on a margin account maintained with Dain Bosworth. Reier was charged interest by Dain Bosworth in connection with said margin account in addition to the profits made by Defendants on each individual sale.

36. All of Defendants' representations contained in paragraph 30 turned out to be false, and the value of the Kroy stock dropped to $3.00 per share, at which price Reier sold the Kroy stock purchased from Defendants.

37. Defendants' actions alleged herein constituted untrue statements of material facts, omissions to state material facts, and a practice or course of business which operated as a fraud upon Reier in connection with a purchase or sale of a security, in violation of Minn. Stat. 80A.01(b) and (c)(1984).

38. As a direct consequence of Defendants' actions, Reier sustained damages in the amount of $12,150.00, together with interest.

ALLEGATIONS REGARDING PLAINTIFFS RUETTENS

39. Paragraphs 1 through 5 are realleged.

40. Between September 11, 1984 and January 8, 1985, Defendants solicited Roger Ruetten to buy certain shares of common stock of Kroy.

41. Defendants made untrue statements of material facts in the solicitation of Roger Ruetten, including, but not limited to, the following:

(a) That Defendants had an "inside track" that Kroy was going to be acquired.

(b) That Ruetten should "load up" on Kroy stock because the stock price should be going up as a result of the acquisition.

(c) On December 4, 1984, Defendant O'Brien advised Roger Ruetten that if Hallmark did not acquire Kroy, two other companies were eager to acquire Kroy and any acquisition would greatly increase the value of Kroy stock.

(d) That as a result of the acquisition of Kroy by 3M Company and/or Hallmark, the value of Kroy stock would double.

42. Defendants omitted material facts in the solicitation of Ruetten to purchase Kroy stock, including, but not limited to, the following:

(a) Defendants did not explain that Defendants were "market makers" in Kroy.

(b) Defendants placed Ruetten on a margin account without an adequate explanation of said account knowing Ruetten was an unsophisticated trader.

43. Said representations contained in paragraph 41 and the omissions contained in paragraph 42 were made repeatedly to induce the Ruettens to invest repeatedly in Kroy stock, and they did in fact induce the Ruettens to do so, as herein alleged.

44. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

45. At the time of said solicitation, Ruetten was not aware that the Defendants' representations were false and misleading, and relying upon said representations, Ruetten entered into various contracts with Defendants for the ultimate purchase from them of 4,100 shares of common stock of Kroy at an average purchase price of $13.13 per share.

Were it not for the misrepresentations of O'Brien, Ruetten would not have purchased said shares of stock.

46. Roger Ruetten purchased the shares of Kroy stock on a margin account maintained in the name of his wife, Margaret R. Ruetten, with Defendants. The Ruettens were charged interest by Defendants in connection with said margin account in addition to the profits made by Defendants on each individual sale.

47. All of Defendants representations contained in paragraph 41 turned out to be false, and the value of the Kroy stock dropped to an average of $6.61 per share, at which price Defendants sold out Ruetten's entire holding of Kroy stock to meet margin calls on their account.

48. As a direct consequence of Defendants' actions, the Ruettens sustained damages in the amount of $26,732.00, together with interest.

49. Ruetten has demanded payment to him by Defendants of the damages sustained as a result of the Kroy stock transactions, together with interest, but Defendants have failed and refused to pay said damages.

ALLEGATIONS PERTAINING TO ALL PLAINTIFFS

50. Defendant Dain Bosworth, at all times material hereto, directly controlled Defendant O'Brien, by being O'Brien's employer in the business of stock brokerage and dealership, and Defendant Dain Bosworth, knew, or in the exercise of reasonable care should have known, the material facts regarding the transactions alleged herein.

51. Defendant Dain Bosworth, at all times material hereto, was the principal of Defendant O'Brien, and exercised, or had the right to exercise, control over the details of O'Brien's activities in the transactions herein alleged, and Defendant O'Brien, in carrying out the transactions alleged herein, acted within the scope of his employment with Defendant Dain Bosworth.

52. Defendant Dain Bosworth, is liable to the Plaintiffs for the damages sustained by them as alleged herein, by virtue of being a control person of Defendant O'Brien, pursuant to Minn. Stat. §80A.23, Subd. 3 (1985).

53. Defendant Dain Bosworth, is liable to the plaintiffs for the damages sustained by them as alleged herein, by virtue of being a master of Defendant O'Brien, in the transactions alleged herein, under the doctrine of respondeat superior.

WHEREFORE, Plaintiffs pray judgment as follows:

1. In favor of Plaintiff, Johnson, against Defendants in the sum of $167,270.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

2. In favor of Plaintiff, Carter, against Defendants in the sum of $540,380.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

3. In favor of Plaintiff, Reier, against Defendants in the sum of $16,200.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

4. In favor of Plaintiffs, Ruettens, against Defendants in the sum of $26,732.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

THUET, LYNCH, PUGH & ROGOSHESKE
/s/ Paul W. Rogosheske
Atty. Reg. No. 92861
Attorneys for Plaintiffs
833 Southview Blvd.
South St. Paul, MN 55075

(Title of Cause)

FIRST AMENDED COMPLAINT

Plaintiffs, as and for their Complaint against Defendants, state and allege:

GENERAL ALLEGATIONS

1. At all times material hereto, Plaintiffs, David S. Johnson (Johnson), James Reier (Reier), Roger Ruetten and Margaret Ruetten (Ruettens) have been residents of Washington County, Minnesota, and Plaintiffs, Kenneth E. Carter and Shirley R. Carter (Carters), have been residents of the State of Colorado.

2. Defendant, Dain Bosworth, Incorporated (Dain Bosworth) is a broker dealer registered with the U.S. Securities and Exchange Commission under Section 15(b) of the Securities and Exchange Act of 1934, 15 USC §78o(b) (1985), and licensed by the Minnesota Commissioner of Commerce under Minn. Stat. 80.04, Subd. 1.

3. At all times material hereto, Defendant, Michael L. O'Brien (O'Brien), was a registered representative under the United States Securities Exchange Act of 1934 and a licensed agent under Minn. Stat. 80A.04, Subd. 1, and employed by Defendant, Dain Bosworth, as its agent.

4. Defendants are subject to the provisions of Minn. Stat. 80.01, et. seq. and Section 12 of the Securities Exchange Act of 1933, 15 USC §771.

5. At all times material hereto, Defendants acted as "market maker" of Kroy Incorporated (Kroy) stock as defined in §3(a)38 of the U.S. Securities Exchange Act of 1934, 15 USC §78c(a)(38)(1985).

ALLEGATIONS REGARDING PLAINTIFF JOHNSON

6. Paragraphs 1 through 5 are realleged.

7. Between October 9, 1984 and March of 1985, Defendants solicited Johnson to buy certain shares of common stock of Kroy.

8. Defendants made untrue statements of material facts or omitted to state material facts necessary to make the statements made not misleading in the solicitation of Johnson, including, but not limited to, the following:

(a) That Defendant O'Brien had "inside information" that Kroy was to be acquired by 3M Co. at a price of $21.00 per share, and that this acquisition could be part stock and part cash depending on the price of 3M stock. In any event, the acquisition would increase the value of the Kroy stock to at least $21.00 per share.

(b) That the "inside information" came from William Clapp, a member of the Board of Directors of Kroy who indicated that a purchase of Kroy stock at less than $15.00 a share would be profitable.

(c) That the investment had no "downside risks" and was a "sure thing."

(d) That in the event the acquisition of Kroy by 3M Company failed to be consummated, two other companies, Hallmark Inc. and a West German company, were each eager to acquire Kroy and such acquisition would greatly increase the value of Kroy common stock.

9. Said representations contained in paragraph 8 were made repeatedly to induce Johnson to invest repeatedly in Kroy stock, and they did in fact induce Johnson to do so, as herein alleged.

10. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

11. At the time of said solicitation, Johnson was not aware that the Defendants' representations were false and misleading, and relying upon said representations, Johnson entered into various contracts with Defendants for the ultimate purchase from them of 17,000 shares of common stock of Kroy at an average purchase price of $12.31 per share. Were it not for the Defendants' misrepresentations, Johnson would not have purchased said shares of stock.

12. Johnson purchased the shares of Kroy stock on a margin account maintained with Dain Bosworth. Interest was charged Johnson by Dain Bosworth in connection with

said margin account in addition to profits made by defendants on each individual sale.

13. All of Defendants' representations contained in paragraph 8 turned out to be false, and the value of the Kroy stock dropped to an average of $7.00 per share, at which price Johnson sold 6,000 shares of Kroy stock.

14. Defendants' actions alleged herein constituted untrue statements of material facts, omissions to state material facts, and a practice or course of business which operated as a fraud or deceit upon Johnson, in connection with the purchase or sale of a security, in violation of Minn. Stat. 80A.01(b) and (c)(1984) and 15 USC §771(2).

15. As a direct consequence of Defendants' actions, Johnson sustained damages in the amount of $31,860.00 on the sale of 6,000 shares, together with interest.

16. Johnson hereby tenders to the Defendants the 11,000 shares of Kroy stock still held by him and demands the return of $135,410.00 paid for these shares, together with interest.

ALLEGATIONS REGARDING PLAINTIFF CARTER

17. Paragraphs 1 through 5 are realleged.

18. Between October 5, 1984 and March of 1985, Defendants solicited Kenneth E. Carter to buy certain shares of common stock of Kroy.

19. Defendants made untrue statements of material facts, or omitted to state material facts necessary to make the statements made not misleading in the solicitation of Carter including, but not limited to, the following:

(a) That Defendant O'Brien had information from a director of Kroy that Kroy was to be acquired by 3M Company within two months.

(b) That any purchase of Kroy stock at less than $15.00 per share would be profitable as a result of the acquisition.

(c) That in the event the acquisition of Kroy by 3M Company was not consummated, two other substantial enterprises were eager to acquire Kroy and any such acquisition would greatly increase the value of Kroy common stock.

(d) That negotiations for the acquisition of Kroy by 3M Company were progressing smoothly and that the announcement of the acquisition was imminent.

20. The representations by Defendants to Kenneth E. Carter contained in paragraph 19 were made repeatedly to induce Kenneth E. Carter to invest repeatedly in Kroy stock, and they did in fact induce Kenneth E. Carter to do so, as herein alleged.

21. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

22. At the time of said solicitation, Kenneth E. Carter was not aware that Defendants' representations were false and misleading, and relying upon said representations, Kenneth E. Carter entered into various contracts with Defendants for the ultimate purchase from them of 41,000 shares of common stock of Kroy at an average price of $13.18 per share. Were it not for the misrepresentations of O'Brien, Kenneth E. Carter would not have purchased said shares of stock.

23. Kenneth E. Carter purchased the shares of Kroy stock on a margin account maintained with Defendants and transferred the shares to his wife, Shirley R. Carter, on April 24, 1985. Carters were charged interest by Defendants in connection with said margin account in addition to the profits made by Defendants on each individual sale.

24. All of Defendants' representations contained in paragraph 19 turned out to be false, and the value of the Kroy stock dropped to $9.00 per share by the date of commencement of this action.

25. Defendants' actions alleged herein constituted untrue statements of material facts, omissions to state material facts, and a practice or course of business which operated as a fraud or deceit upon Carters, in connection with a purchase or sale of a security, in violation of Minn. Stat. 80A.01(b) and (c)(1984) and 15 USC §771(2).

26. Carters hereby tender to the Defendants the 41,000 shares of Kroy stock held by them and demand the return of $540,380.00 paid for these shares, together with interest.

27. Carters have demanded payment to them by Defendants of the amount paid for the stock, a total of $540,215.25, together with interest, but Defendants have failed and refused to return any of the monies paid for the stock.

ALLEGATIONS REGARDING PLAINTIFF REIER

28. Paragraphs 1 through 5 are realleged.

29. Between October 9, 1985 and March of 1986, Defendants solicited Reier to buy certain shares of common stock of Kroy.

30. Defendants made untrue statements of material facts or omitted to state material facts necessary to make the statements made not misleading in the solicitation of Reier, including, but not limited to, the following:

(a) That Defendant O'Brien had "inside information" that Kroy was to be acquired by 3M Co. at a price in the high teens or low twenties per share, and that this acquisition would increase the value of the Kroy stock to at least in the high teens or low twenties per share.

(b) That the investment had no "downside risks" and was a "sure thing."

(c) That Defendant O'Brien would "bird dog" the stock to ensure no risk at all to Reier.

31. Defendants omitted to state material facts in the solicitation of Reier to purchase Kroy stock, including, but not limited to, the following:

(a) Defendants did not explain that Defendants were "market makers" in Kroy.

(b) Defendants placed Reier on a margin account without an adequate explanation of said account, knowing Reier was an unsophisticated investor.

32. Said representations contained in paragraph 30 and the omissions contained in paragraph 31 were made repeatedly to induce Reier to invest in Kroy stock, and they did in fact induce Reier to do so, as herein alleged.

33. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

34. At the time of said solicitation, Reier was not aware that the Defendants' representations were false and misleading, and relying upon said representations, Reier entered into a contract with Defendants for the purchase from them of 1,350 shares of common stock of Kroy at an average purchase price of $12.00 per share. Were it not for the misrepresentations of O'Brien, Reier would not have purchased said shares of stock.

35. Reier purchased some of the shares of Kroy stock on a margin account maintained with Dain Bosworth. Reier was charged interest by Dain Bosworth in connection with said margin account in addition to the profits made by Defendants on each individual sale.

36. All of Defendants' representations contained in paragraph 30 turned out to be false, and the value of the Kroy stock dropped to $3.00 per share, at which price Reier sold the Kroy stock purchased from Defendants.

37. Defendants' actions alleged herein constituted untrue statements of material facts, omissions to state material facts, and a practice or course of business which operated as a fraud upon Reier in connection with a purchase or sale of a security, in violation of Minn. Stat. 80A.01(b) and (c)(1984) and 15 USC §771 (2).

38. As a direct consequence of Defendants' actions, Reier sustained damages in the amount of $12,150.00, together with interest.

ALLEGATIONS REGARDING PLAINTIFFS RUETTENS

39. Paragraphs 1 through 5 are realleged.

40. Between September 11, 1984 and January 8, 1985, Defendants solicited Roger Ruetten to buy certain shares of common stock of Kroy.

41. Defendants made untrue statements of material facts or omitted to state material facts necessary to make the statements made not misleading in the solicitation of Roger Ruetten, including, but not limited to, the following:

(a) That Defendants had an "inside track" that Kroy was going to be acquired.

(b) That Ruetten should "load up" on Kroy stock because the stock price should be going up as a result of the acquisition.

(c) On December 4, 1984, Defendant O'Brien advised Roger Ruetten that if Hallmark did not acquire Kroy, two other companies were eager to acquire Kroy and any acquisition would greatly increase the value of Kroy stock.

(d) That as a result of the acquisition of Kroy by 3M Company and/or Hallmark, the value of Kroy stock would double.

42. Defendants omitted material facts in the solicitation of Ruetten to purchase Kroy stock, including, but not limited to, the following:

(a) Defendants did not explain that Defendants were "market makers" in Kroy.

(b) Defendants placed Ruetten on a margin account without an adequate explanation of said account knowing Ruetten was an unsophisticated trader.

43. Said representations contained in paragraph 41 and the omissions contained in paragraph 42 were made repeatedly to induce the Ruettens to invest repeatedly in Kroy stock, and they did in fact induce the Ruettens to do so, as herein alleged.

44. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

45. At the time of said solicitation, Ruetten was not aware that the Defendants' representations were false and misleading, and relying upon said representations, Ruetten entered into various contracts with Defendants for the ultimate purchase from them of 4,100 shares of common stock of Kroy at an average purchase price of $13.13 per share. Were it not for the misrepresentations of O'Brien, Ruetten would not have purchased said shares of stock.

46. Roger Ruetten purchased the shares of Kroy stock on a margin account maintained in the name of his wife, Margaret R. Ruetten, with Defendants. The Ruettens were charged interest by Defendants in connection with said margin account in addition to the profits made by Defendants on each individual sale.

47. All of Defendants representations contained in paragraph 41 turned out to be false, and the value of the Kroy stock dropped to an average of $6.61 per share, at which price Defendants sold out Ruetten's entire holding of Kroy stock to meet margin calls on their account.

48. As a direct consequence of Defendants' actions, the Ruettens sustained damages in the amount of $26,732.00, together with interest.

49. Defendants' actions alleged herein constituted untrue statements of material facts, omissions to state material facts, and a practice or course of business which operated as a fraud upon the Ruettens in connection with a purchase or sale of a security, in violation of Minn. Stat. 80A.01(b) and (c)(1984) and 15 U.S.C. §771 (2).

50. Ruetten has demanded payment to him by Defendants of the damages sustained as a result of the Kroy stock transactions, together with interest, but Defendants have failed and refused to pay said damages.

ALLEGATIONS PERTAINING TO ALL PLAINTIFFS

51. Defendant Dain Bosworth, at all times material hereto, directly controlled Defendant O'Brien, by being O'Brien's employer in the business of stock brokerage and dealership, and Defendant Dain Bosworth, knew, or in the exercise of reasonable care should have known, the material facts regarding the transactions alleged herein.

52. Defendant Dain Bosworth, at all times material hereto, was the principal of Defendant O'Brien, and exercised, or had the right to exercise, control over the details of O'Brien's activities in the transactions herein alleged, and Defendant O'Brien, in carrying out the transactions alleged herein, acted within the scope of his employment with Defendant Dain Bosworth.

53. Defendant Dain Bosworth, is liable to the Plaintiffs for the damages sustained by them as alleged herein, by

virtue of being a control person of Defendant O'Brien, pursuant to Minn. Stat. §80A.23, Subd. 3 (1985).

54. Defendant Dain Bosworth, is liable to the plaintiffs for the damages sustained by them as alleged herein, by virtue of being a master of Defendant O'Brien, in the transactions alleged herein, under the doctrine of respondeat superior.

55. Defendant Dain Bosworth had a duty to supervise its agents and employees to insure that they conducted themselves in an ethical and profitable manner with respect to Plaintiffs' accounts and to insure that Plaintiffs' accounts were properly handled and managed.

56. Defendant Dain Bosworth breached its duty of care to supervise its agents and employees by failing adequately to supervise Defendant O'Brien during the period when Defendant O'Brien was handling Plaintiffs' accounts with Defendant Dain Bosworth.

57. As a direct result of Defendant Dain Bosworth's negligence in its duty to supervise Defendant O'Brien, Plaintiffs have suffered damages.

58. Defendants Dain Bosworth and O'Brien made material misrepresentations and omitted material facts as more fully set out in this Complaint. The Defendants material misrepresentations and omitted facts were made with an intent to defraud.

59. Defendants made the representations and omissions set forth herein with an intent to defraud Plaintiffs. Defendants knew the representations were false and made them in reckless and negligent disregard for their truth.

60. Plaintiffs relied on Defendants' misrepresentations and acted without knowledge of their omissions.

61. As a direct result of the misrepresentations and omissions of Defendants, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs pray judgment as follows:

1. In favor of Plaintiff, Johnson, against Defendants in the sum of $167,270.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

2. In favor of Plaintiff, Carter, against Defendants in the sum of $540,380.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

3. In favor of Plaintiff, Reier, against Defendants in the sum of $16,200.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

4. In favor of Plaintiffs, Ruettens, against Defendants in the sum of $26,732.00, together with interest, costs, disbursements, and reasonable attorney's fees pursuant to Minnesota Statutes 80A.23.

THUET, LYNCH, PUGH & ROGOSHESKE
/s/ Paul W. Rogosheske
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833 Southview Blvd.
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Attorneys for Plaintiffs

STATE OF MINNESOTA
County of Washington

DISTRICT COURT
Tenth Judicial District

Type of case: Other Civil

David S. Johnson, Kenneth E. Carter, and Shirley R. Carter,
Plaintiffs,

vs.

Michael L. O'Brien and Dain Bosworth, Incorporated,
Defendants.

SECOND AMENDED COMPLAINT

Plaintiffs, as and for their Complaint against Defendants, state and allege:

GENERAL ALLEGATIONS

1. At all times material hereto, Plaintiff David S. Johnson (Johnson), has been a resident of Washington County, Minnesota, and Plaintiffs Kenneth E. Carter and Shirley R. Carter (Carters), have been residents of the State of Colorado.

2. Defendant Dain Bosworth, Incorporated (Dain Bosworth) is a broker dealer registered with the U. S. Securities and Exchange Commission under Section 15(b) of the Securities and Exchange Act of 1934, 15 USC §78o(b) (1985), and licensed by the Minnesota Commissioner of Commerce under Minn. Stat. 80.04, Subd. 1.

3. At all times material hereto, Defendant Michael L. O'Brien (O'Brien), was a registered representative under the United States Securities Exchange Act of 1934 and a li-

censed agent under Minn. Stat. 80A.04, Subd. 1, and employed by Defendant Dain Bosworth as its agent.

4. Defendants are subject to the provisions of Section 12 of the Securities Exchange Act of 1933, 15 USC §771.

5. At all times material hereto, Defendants acted as "market maker" of Kroy Incorporated (Kroy) stock as defined in §3(a)38 of the U. S. Securities Exchange Act of 1934, 15 USC §78c(a)(38)(1985).

ALLEGATIONS REGARDING PLAINTIFF JOHNSON

6. Paragraphs 1 through 5 are realleged.

7. Between October 9, 1984 and March of 1985, Defendants solicited Johnson to buy certain shares of common stock of Kroy.

8. Defendants made untrue statements of material facts or omitted to state material facts necessary to make the statements made not misleading in the solicitation of Johnson, including, but not limited to, the following:

(a) That Defendant O'Brien had "inside information" that Kroy was to be acquired by 3M Co. at a price of $21.00 per share, and that this acquisition could be part stock and part cash depending on the price of 3M stock. In any event, the acquisition would increase the value of the Kroy stock to at least $21.00 per share.

(b) That the "inside information" came from William Klapp, a member of the Board of Directors of Kroy who indicated that a purchase of Kroy stock at less than $15.00 a share would be profitable.

(c) That the investment had no "downside risks" and was a "sure thing."

(d) That in the event the acquisition of Kroy by 3M Company failed to be consummated, two other companies, Hallmark Inc. and a West German company, were each eager to acquire Kroy and such acquisition would greatly increase the value of Kroy common stock.

9. Said representations contained in paragraph 8 were made repeatedly to induce Johnson to invest repeatedly in Kroy stock, and they did in fact induce Johnson to do so, as herein alleged.

10. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

11. At the time of said solicitation, Johnson was not aware that the Defendants' representations were false and misleading, and relying upon said representations, Johnson entered into various contracts with Defendants for the ultimate purchase from them of 17,000 shares of common stock of Kroy as hereinafter set forth:

DATE PURCHASED	NUMBER OF SHARES	COST PER SHARE	TOTAL
10-9-84	3000	$12.00	$36,001.75
10-29-84	3000	14.25	42,751.75
11-12-84	1000	10.25	10,251.75
11-21-84	3000	11.375	34,125.00
11-27-84	5000	12.25	61,250.00
12-4-84	2000	12.50	25,000.00
TOTAL	17,000		$209,380.25

Were it not for the Defendants' misrepresentations, Johnson would not have purchased said shares of stock.

12. Johnson purchased the shares of Kroy stock on a margin account maintained with Dain Bosworth. Interest was charged Johnson by Dain Bosworth in connection with said margin account in the amount of $12,940.48 in addition to profits made by defendants on each individual sale.

13. All of Defendants' representations contained in paragraph 8 turned out to be false, and the value of the Kroy stock dropped to approximately $7.00 per share in April of 1985, at which time Johnson confronted O'Brien and realized the representations made by O'Brien were false. At this time Johnson made a second independent investment decision to retain the shares of Kroy stock.

14. Defendants' actions alleged herein constituted untrue statements of material facts, omissions to state material facts, and a practice or course of business which operated as a fraud or deceit upon Johnson, in connection with the purchase or sale of a security, in violation of 15 USC §771(2).

15. As a direct consequence of Defendants' actions, Johnson sustained damages in the amount of $90,380.25, together with interest paid by Johnson on his margin account with defendants.

ALLEGATIONS REGARDING PLAINTIFF CARTER

16. Paragraphs 1 through 5 are realleged.

17. Between October 5, 1984 and March of 1985, Defendants solicited Kenneth E. Carter to buy certain shares of common stock of Kroy.

18. Defendants made untrue statements of material facts, or omitted to state material facts necessary to make the statements made not misleading in the solicitation of Carter including, but not limited to, the following:

(a) That Defendant O'Brien had information from a director of Kroy that Kroy was to be acquired by 3M Company within two months.

(b) That any purchase of Kroy stock at less than $15.00 per share would be profitable as a result of the acquisition.

(c) That in the event the acquisition of Kroy by 3M Company was not consummated, two other substantial enterprises were eager to acquire Kroy and any such acquisition would greatly increase the value of Kroy common stock.

(d) That negotiations for the acquisition of Kroy by 3M Company were progressing smoothly and that the announcement of the acquisition was imminent.

19. The representations by Defendants to Kenneth E. Carter contained in paragraph 19 were made repeatedly to induce Kenneth E. Carter to invest repeatedly in Kroy stock, and they did in fact induce Kenneth E. Carter to do so, as herein alleged.

20. Defendants made these untrue statements of material facts either knowing that they were untrue, or with reckless disregard for their truth or falsity.

21. At the time of said solicitation, Kenneth E. Carter was not aware that Defendants' representations were false and misleading, and relying upon said representations,

Kenneth E. Carter entered into various contracts with Defendants for the ultimate purchase from them of 41,000 shares of common stock as hereinafter set forth:

DATE PURCHASED	NUMBER OF SHARES	COST PER SHARE	TOTAL
10-9-84	4000	$12.00	$48,001.75
10-29-84	3000	14.25	42,751.75
11-12-84	1000	10.25	10,251.75
11-15-84	1000	10.625	10,625.00
11-19-84	1000	11.375	11,376.75
11-23-84	10,000	11.375	113,750.00
11-28-84	5000	12.50	62,500.00
12-11-84	3000	13.00	39,000.00
12-17-84	5000	12.75	63,750.00
12-28-84	5000	12.25	61,250.00
2-27-85	3000	9.25	27,750.00
TOTAL	41,000		$491,007.00

Were it not for the misrepresentations of O'Brien, Kenneth E. Carter would not have purchased said shares of stock.

22. Kenneth E. Carter purchased the shares of Kroy stock on a margin account maintained with Defendants and transferred the shares to his wife, Shirley R. Carter, on April 24, 1985. Carters were charged interest by Defendants in connection with said margin account in the amount of $32,402.18 in addition to the profits made by Defendants on each individual sale.

23. All of Defendants' representations contained in paragraph 19 turned out to be false, and the value of the Kroy stock dropped to approximately $7.00 per share in April of 1985 at which time Carter confronted O'Brien and realized the representations made by O'Brien were false.

At this time, Carter made a second independent investment decision to retain the share of Kroy stock.

24. Defendants' actions alleged herein constituted untrue statements of material facts, omissions to state material facts, and a practice or course of business which operated as a fraud or deceit upon Carters, in connection with a purchase or sale of a security, in violation of 15 USC §771 (2).

25. As a direct consequence of Defendants' actions, Carters sustained damages in the amount of $204,007.00 together with interest paid by Carters on their margin account with Defendants.

ALLEGATIONS PERTAINING TO ALL PLAINTIFFS

26. Defendant Dain Bosworth, at all times material hereto, directly controlled Defendant O'Brien, by being O'Brien's employer in the business of stock brokerage and dealership, and Defendant Dain Bosworth, knew, or in the exercise of reasonable care should have known, the material facts regarding the transactions alleged herein.

27. Defendant Dain Bosworth, at all times material hereto, was the principal of Defendant O'Brien, and exercised, or had the right to exercise, control over the details of O'Brien's activities in the transactions herein alleged, and Defendant O'Brien, in carrying out the transactions alleged herein, acted within the scope of his employment with Defendant Dain Bosworth.

28. Defendant Dain Bosworth, is liable to the plaintiffs for the damages sustained by them as alleged herein, by

virtue of being a master of Defendant O'Brien, in the transactions alleged herein, under the doctrine of respondeat superior.

WHEREFORE, Plaintiffs pray judgment as follows:

1. In favor of Plaintiff Johnson, against Defendants in the sum of $103,320.73, together with interest, costs, and disbursements herein.

2. In favor of Plaintiff Carter, against Defendants in the sum of $236,409.18, together with interest, costs, and disbursements herein.

THUET, LYNCH, PUGH & ROGOSHESKE
/s/ Edward Lynch
Atty. Reg. No. 65547
833 Southview Blvd.
South St. Paul, MN 55075
Attorneys for Plaintiffs

ACKNOWLEDGMENT

The undersigned hereby acknowledges that costs, disbursements, and reasonable attorney and witness fees may be awarded pursuant to Minn. Stat. §549.21, subdivision 2, to the party against whom the allegations in this pleading are asserted.

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/s/ Edward Lynch
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South St. Paul, Minnesota 55075
(612) 451-6411
Attorneys for Plaintiff

(Title of Cause)

DEFENDANT DAIN BOSWORTH INCORPORATED'S NOTICE OF MOTION AND MOTION TO COMPEL ARBITRATION AND TO STAY PROCEEDINGS.

TO: Plaintiffs above-named and their attorney, Edward Lynch, of Thuet, Lynch, Pugh & Rogosheske, 833 Southview Boulevard, South St. Paul, Minnesota 55075.

PLEASE TAKE NOTICE that on June 10, 1987 at 9:30 a.m., or as soon thereafter as counsel may be heard, at the Washington County Courthouse, Stillwater, Minnesota 55082, defendant Dain Bosworth Incorporated will move the Court for an Order pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, compelling arbitration of plaintiffs' claims and staying all proceedings, including discovery, pending resolution of that arbitration.

This Motion is based on the accompanying Memorandum of Law, the Affidavits of Maureen McCallum and Edward J. Pluimer and all the files, records and proceedings herein.

Dated: May 22, 1987

DORSEY & WHITNEY
/s/ EDWARD J. PLUIMER
Atty. Reg. No. 87208
/s/ JAMES K. LANGDON II
Atty. Reg. No. 171931
2200 First Bank Place East
Minneapolis, MN 55402
Telephone: (612) 340-2973/8754
Attorneys for Defendant
Dain Bosworth Incorporated

The following provision appears in the Customer's Margin Agreements executed by Kenneth E. Carter and David S. Johnson:

> 10. Any controversy between you and me arising out of or relating to this agreement or the breach thereof shall be settled by arbitration in accordance with the rules then obtaining of the New York Stock Exchange, or if the New York Stock Exchange declines to accept jurisdiction, then of the American Arbitration Association. Unless otherwise provided by the applicable rules, any arbitration hereunder shall be before three (3) arbitrators. The award of the arbitrators or a majority of them shall be final and judgment upon the award rendered may be entered in any court, state or federal, having jurisdiction.

(2)

No. 88-284

FILE
SEP 14 19
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IN THE

Supreme Court of the United States

October Term, 1987

DAIN BOSWORTH INCORPORATED,
Petitioner,

vs.

DAVID S. JOHNSON, KENNETH E. CARTER AND SHIRLEY R. CARTER,
Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF MINNESOTA

EDWARD LYNCH
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September 7, 1988

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QUESTION PRESENTED

Whether a predispute agreement to arbitrate disputes between a securities broker and investor is enforceable with respect to claims brought under Section 12(2) of the Securities Act of 1933, 15 USC §77 1.

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IN THE

Supreme Court of the United States

No. 88-284

October Term, 1987

DAIN BOSWORTH INCORPORATED,
Petitioner,

vs.

DAVID S. JOHNSON, KENNETH E. CARTER AND SHIRLEY R. CARTER,
Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF MINNESOTA

STATEMENT OF THE CASE

Respondents are individual investors who have suffered substantial financial losses as a result of investing in securities of Kroy Incorporated. Respondents' investments in Kroy Incorporated were solicited by Petitioner's registered representative, Michael O'Brien. Respondents commenced this action against Petitioner and O'Brien alleging violations of Section 12(2) of the Securities Act of 1933, 15 USC §771(2).

Petitioner moved the trial court to compel arbitration of Respondents' claims based upon a predispute arbitration

clause contained in Petitioner's non-negotiated Margin Agreements signed by Respondents. The trial court, relying upon this Court's holding in *Wilko v. Swan*, 346 U.S. 427 (1953), denied Petitioner's motion. The Minnesota Court of Appeals affirmed the trial court, 420 NW2d 264 (Minn. App. 1988) and the Minnesota Supreme Court in an unpublished order declined to review the decision of the Minnesota Court of Appeals.

Petitioner seeks a Writ of Certiorari from this Court arguing that the recent decision of *Shearson/American Express, Inc. v. McMahon*, — U. S. —, 107 S. Ct. 2332 (1987) requires arbitration of Respondents' Section 12(2) claims.

ARGUMENT AGAINST GRANTING THE WRIT

The *Wilko* holding has been followed and relied upon for over 30 years; the decision is predicated upon a determination that the non waiver provisions of Section 14 of the Securities Act of 1933 precluded enforcement of predispute arbitration agreements.

Petitioner's assertion that the *McMahon* decision undermines *Wilko* is without merit. *McMahon* merely declined to extend the holding of *Wilko* to claims brought under the Securities Exchange Act of 1934. This Court properly refused to overrule *Wilko* and its application to claims brought under the Securities Act of 1933. Consequently *Wilko* continues to mandate that predispute arbitration agreements are not enforceable with respect to claims brought under the Securities Act of 1933.

Wilko determined that Congress intended that Section 14 of the Securities Act of 1933 precluded enforcement of predispute arbitration agreements with respect to claims

brought under the 1933 Act, 346 U. S. at 437. Congress has not amended Section 14 of the Securities Act of 1933 since *Wilko* was decided and the intent of Congress necessarily remains unchanged.

The *McMahon* decision recognized that the "Arbitration Act's mandate may be overridden by a contrary congressional command," 107 S. Ct. at 2337 and acknowledged that the application of the Arbitration Act (9 U.S.C. §1 et. seq.) may be defeated by demonstrating that Congress intended an exception to the Arbitration Act for the particular claim in question. *Wilko* establishes that Congress intended an exception to the Arbitration Act for claims brought under §12(2) of the Securities Act of 1933. Indeed, *McMahon* suggests Congress reaffirmed its intent that predispute arbitration agreements are not enforceable with respect to the Securities Act of 1933 by the reference to *Wilko* in the conference report regarding amendments to Section 28 of the Securities Act of 1934: ". . . the committee may simply have wished to make clear that the amendment to §28(b) was not otherwise intended to affect *Wilko's* construction of the Securities Act," 107 S. Ct. at 2343.

The *McMahon* decision (upon which Petitioner relies in seeking this writ), contrary to Petitioner's arguments, does not undermine the *Wilko* decision. McMahon refused to overrule *Wilko* and recognized a 1975 Congressional affirmation of the application of the *Wilko* decision to claims brought under the Securities Act of 1933.

CONCLUSION

This court should not disregard the reliance placed upon the *Wilko* decision for over 30 years and ignore the recent Congressional expression of support for the *Wilko* decision found in the legislative history of the 1975 amendments to the Securities Exchange Act of 1934. This court properly declined to overrule *Wilko* in the *McMahon* decision and should resist Petitioner's present assault against *Wilko* by denying the Writ of Certiorari.

Dated: September 7, 1988.

Respectfully submitted,

/s/ EDWARD LYNCH
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Counsel for Respondents David S. Johnson, Kenneth E. Carter and Shirley R. Carter

MOTION FILED
SEP 12 1988

No. 86-284

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

DAIN BOSWORTH INCORPORATED,

Petitioners,

—v.—

DAVID S. JOHNSON, KENNETH R. CARTER, and SHIRLEY R. CARTER,

Respondents.

MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE* AND BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

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as *Amici Curiae*

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-284

DAIN BOSWORTH INCORPORATED,

Petitioner,

—v.—

DAVID S. JOHNSON, KENNETH E. CARTER, and SHIRLEY R. CARTER,

Respondents.

MOTION OF THE SECURITIES INDUSTRY ASSOCIATION, ADVEST, INC., BATEMAN EICHLER, HILL RICHARDS INCORPORATED, BOETTCHER & COMPANY, INC., J.C. BRADFORD & CO., D.A. DAVIDSON & CO., INCORPORATED, DEAN WITTER REYNOLDS INC., A.G. EDWARDS & SONS, INC., GOLDMAN, SACHS & CO., HAMBRECHT & QUIST INCORPORATED, J.J.B. HILLIARD, W.L. LYONS, INC., JOHNSTON, LEMON & CO., INCORPORATED, MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, PIPER, JAFFRAY & HOPWOOD INCORPORATED, PRESCOTT, BALL & TURBEN, INC., RAUSCHER PIERCE REFSNES, INC., RAYMOND, JAMES & ASSOCIATES, INC., SHEARSON LEHMAN HUTTON INC., AND WHEAT, FIRST SECURITIES, INC., FOR LEAVE TO FILE BRIEF *AMICI CURIAE*

The Securities Industry Association ("SIA"), Advest, Inc. ("Advest"), Bateman Eichler, Hill Richards Incorporated ("Bateman Eichler"), Boettcher & Company, Inc. ("Boett-

cher"), J.C. Bradford & Co. ("J.C. Bradford"), D.A. Davidson & Co., Incorporated ("D.A. Davidson"), Dean Witter Reynolds Inc. ("Dean Witter"), A.G. Edwards & Sons, Inc. ("A.G. Edwards"), Goldman, Sachs & Co. ("Goldman"), Hambrecht & Quist Incorporated ("Hambrecht"), J.J.B. Hilliard, W.L. Lyons, Inc. ("Hilliard Lyons"), Johnston, Lemon & Co., Incorporated ("Johnston Lemon"), Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Piper, Jaffray & Hopwood Incorporated ("Piper Jaffray"), Prescott, Ball & Turben, Inc. ("Prescott Ball"), Rauscher Pierce Refsnes, Inc. ("Rauscher Pierce"), Raymond, James & Associates, Inc. ("Raymond James"), Shearson Lehman Hutton Inc. ("Shearson"), and Wheat, First Securities, Inc. ("Wheat First"), hereby respectfully move, pursuant to Rule 42 of this Court, for leave to file the annexed brief as *amici curiae* urging reversal of the decision below of the Minnesota Court of Appeals. The consent of Dain Bosworth Incorporated, the Petitioner, has been obtained. Consent of the Respondents has been requested but was not granted.

INTEREST OF *AMICI CURIAE*

SIA is the principal trade association of the securities industry, having as members more than five hundred and fifty securities firms in the United States and Canada. As such, it has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers may be enforced. Because arbitration is an efficient, fair, and economical manner of resolving disputes, most of SIA's members have agreed with many of their customers to arbitrate any controversies arising between them. Among these members are *amici curiae* Advest, Bateman Eichler, Boettcher, J.C. Bradford, D.A. Davidson, Dean Witter, A.G. Edwards, Goldman, Hambrecht, Hilliard Lyons, Johnston Lemon, Merrill Lynch, Piper Jaffray, Prescott Ball, Rauscher Pierce, Raymond James, Shearson, and Wheat First.

Certain *amici* are parties to cases pending in the lower federal courts that involve the issue presented on this petition. The pro-

cedural outcome of those actions will be affected by any decision taken by this Court on this petition. *Amici curiae* therefore have a substantial interest in seeing this Court resolve whether agreements to arbitrate claims arising under the Section 12(2) of Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"), are enforceable as valid contracts under Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (the "Arbitration Act"), as is the case with claims arising under the Securities Exchange Act of 1934, 15 U.S.C. § 78 (the "Exchange Act"). *Amici* seek to clarify and make uniform the law on this issue so that the enforceability of arbitration provisions in agreements with their customers can be predicted and relied upon. SIA has also filed briefs *amicus curiae* on the enforceability of agreements to arbitrate Exchange Act claims to this Court in *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213 (1985), and in *Shearson/American Express, Inc.* v. *McMahon*, ____ U.S. ____, 107 S.Ct. 2332 (1987).

Amici curiae firmly believe that the Minnesota Court of Appeals erred below. The Court of Appeals, notwithstanding the congressional policy favoring arbitration contained in the Arbitration Act, voided an agreement to arbitrate future claims brought under Section 12(2) as a waiver of compliance with the Securities Act. It did so, even though this Court held that such an agreement would not waive compliance with the Exchange Act in *Shearson/American Express, Inc.* v. *McMahon*, because of this Court's earlier decision in *Wilko* v. *Swan*, 346 U.S. 427 (1953), which had voided agreements to arbitrate Section 12(2) claims based on an undocumented suspicion of arbitration. *Amici* respectfully suggest that *McMahon* rejected both *Wilko*'s legal reasoning and its unequivocal hostility towards arbitration as a matter of policy, and that *Wilko* should therefore be overruled.

Amici move for leave to file this brief in order to put facts relating to arbitration practice in the securities industry before the Court. *See* proposed brief, *infra*, at 5-14. These facts, *amici* respectfully submit, will assist the Court in deciding whether to grant a writ of *certiorari*. They bear out the Court's approval of securities industry arbitration—and thus its conclusion that an

agreement to arbitrate Exchange Act claims does not waive compliance with the Exchange Act—in *McMahon*. By the same token, they refute *Wilko*'s negative assumptions about arbitration and thus eliminate the basis of that decision.

WHEREFORE, the Securities Industry Association, Advest, Inc., Bateman Eichler, Hill Richards Incorporated, Boettcher & Company, Inc., J.C. Bradford & Co., D.A. Davidson & Co., Incorporated, Dean Witter Reynolds Inc., A.G. Edwards & Sons, Inc., Goldman Sachs & Co., Hambrecht & Quist Incorporated, J.J.B. Hilliard, W.L. Lyons, Inc., Johnston, Lemon & Co., Incorporated, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Piper, Jaffray & Hopwood Incorporated, Prescott, Ball & Turben, Inc., Rauscher Pierce Refsnes, Inc., Raymond James & Associates, Inc., Shearson Lehman Hutton Inc., and Wheat, First Securities, Inc., respectfully move this Court that leave be granted them to file the brief as *amici curiae*.

Dated: September 12, 1988

Respectfully submitted,

/s/ James K. Manning

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DAVID S. JOHNSON, KENNETH E. CARTER,
and SHIRLEY R. CARTER,

Respondents.

BRIEF OF *AMICI CURIAE* IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

PRELIMINARY STATEMENT

The Securities Industry Association ("SIA"), Advest, Inc. ("Advest"), Bateman Eichler, Hill Richards Incorporated ("Bateman Eichler"), Boettcher & Company, Inc. ("Boettcher"), J.C. Bradford & Co. ("J.C. Bradford"), D.A. Davidson & Co., Incorporated ("D.A. Davidson"), Dean Witter Reynolds Inc. ("Dean Witter"), A.G. Edwards & Sons, Inc. ("A.G. Edwards"), Goldman, Sachs & Co. ("Goldman"), Hambrecht & Quist Incorporated ("Hambrecht"), J.J.B. Hilliard, W.L. Lyons, Inc. ("Hilliard Lyons"), Johnston, Lemon & Co., Incorporated ("Johnston Lemon"), Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Piper, Jaffray & Hopwood Incorporated ("Piper Jaffray"), Prescott,

Ball & Turben, Inc. ("Prescott Ball"), Rauscher Pierce Refsnes, Inc. ("Rauscher Pierce"), Raymond, James & Associates, Inc. ("Raymond James"), Shearson Lehman Hutton Inc. ("Shearson"), and Wheat, First Securities, Inc. ("Wheat First"), submit this brief as *amici curiae* in support of the Petitioner, and urge this Court to issue a writ of *certiorari* to the Supreme Court of the State of Minnesota with respect to the opinion and judgment of the Court of Appeals of the State of Minnesota below in *Johnson* v. *O'Brien*, 420 N.W.2d 264 (Minn. App. 1988), *review denied*, No. C9-97-1784 slip. op. (Minn. May 18, 1988).

INTEREST OF *AMICI CURIAE*

SIA is the principal trade association of the securities industry, having as members more than five hundred and fifty securities firms in the United States and Canada. As such, it has a substantial interest in the extent to which agreements to arbitrate claims between securities firms and their customers may be enforced. Because arbitration is an efficient, fair, and economical manner of resolving disputes, most of SIA's members have agreed with many of their customers to arbitrate any controversies arising between them. Among these members are *amici curiae* Advest, Bateman Eichler, Boettcher, J.C. Bradford, D.A. Davidson, Dean Witter, A.G. Edwards, Goldman, Hambrecht, Hilliard Lyons, Johnston Lemon, Merrill Lynch, Piper Jaffray, Prescott Ball, Rauscher Pierce, Raymond James, Shearson, and Wheat First.

Certain *amici* are parties to cases pending in the lower federal courts that involve the issue presented on this petition. The procedural outcome of those actions will be affected by any decision taken by this Court on this petition. *Amici curiae* therefore have a substantial interest in seeing this Court resolve whether agreements to arbitrate claims arising under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"), are enforceable as valid contracts under Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (the "Arbitration Act"), as is the case with claims arising under the Securities

Exchange Act of 1934, 15 U.S.C. § 78 (the "Exchange Act"). *Amici* seek to clarify and make uniform the law on this issue so that the enforceability of arbitration provisions in agreements with their customers can be predicted and relied upon. SIA has also filed briefs *amicus curiae* on the enforceability of agreements to arbitrate Exchange Act claims to this Court in *Dean Witter Reynolds Inc.* v. *Byrd*, 470 U.S. 213 (1985), and in *Shearson/American Express, Inc.* v. *McMahon*, ____ U.S. ____, 107 S.Ct. 2332 (1987).

REASONS FOR GRANTING A WRIT OF *CERTIORARI*

The issue this petition lays before the Court is whether predispute agreements to arbitrate claims arising under Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2) (the "Securities Act"), are enforceable. Last year, in *Shearson/American Express, Inc.* v. *McMahon*, ____ U.S. ____, 107 S.Ct. 2332 (1987), the Court held that agreements to arbitrate claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act"), were enforceable under the United States Arbitration Act, 9 U.S.C. §§ 1 *et seq.* (the "Arbitration Act"). *McMahon* rejected an argument based on *Wilko* v. *Swan*, 346 U.S. 427 (1953), that an agreement to arbitrate federal securities claims waives substantive rights bestowed by the federal securities laws and is therefore void under the nonwaiver provisions of those laws. In restricting *Wilko* to its peculiar facts, *McMahon* rejected both *Wilko's* general hostility to the arbitration process and its specific reasoning. *Amici* now respectfully ask the Court to make the law in this area uniform by overruling *Wilko*.

SUMMARY OF ARGUMENT

The opinion of the Minnesota Court of Appeals below, *Johnson* v. *O'Brien*, 420 N.W.2d 264 (Minn. App. 1988), *review denied*, No. C9-87-1784 slip op. (Minn. May 18, 1988), held that predispute agreements to arbitrate Section 12(2) claims are

unenforceable as a waiver of compliance with the Securities Act, in spite of this Court's opinion in *Shearson/American Express* v. *McMahon* that such an agreement is *not* a waiver of compliance with the Exchange Act. It did so because it felt constrained to follow the result in *Wilko*, a case whose "continuing validity" it recognized as "questionable" in light of *McMahon*. 420 N.W.2d at 267.

Wilko reflects the suspicion courts once held of the arbitral process, as opposed to the congressionally enacted federal policy recognizing arbitration as an efficient means of resolving disputes. *See Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. at 2340; *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984); *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1 (1983). *Wilko* did not apply the correct standard for determining whether Section 12(2) repealed the Arbitration Act by implication, which standard has been stated by this Court in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72 (1982), and *Morton* v. *Mancari*, 417 U.S. 535 (1974). Rather than searching for statutory language conflicting with the Arbitration Act or legislative history indicating congressional intent to repeal the Arbitration Act, *Wilko* overruled the substantive, congressional policies embodied in the Arbitration Act solely on the basis of its own conception of public policy.

The result the Minnesota Court of Appeals reluctantly reached below can only lead lower courts to stray from the rule laid down by this Court: that the Arbitration Act is valid except where Congress has expressed its intention, either in statutory language or legislative history, to repeal it. It may also encourage parties to cast ordinary broker-customer disputes in terms of Section 12(2) as a device to escape arbitration, which would frustrate the substantive rights established by the Arbitration Act, as appears to have been the case in this action.

Finally, a writ of *certiorari* is appropriate because there exists a split in the circuits. In *Rodriguez De Quijas* v. *Shearson/*

Lehman Brothers, 845 F.2d 1296 (5th Cir. 1988), the Fifth Circuit followed this Court's analysis in *McMahon* and *Mitsubishi*, and enforced a predispute agreement to arbitrate claims arising under Section 12(2). By contrast, the Second Circuit has held in *dictum* that *Wilko* remains good law because this Court did not explicitly overrule it in *McMahon*. *Chang* v. *Lin*, 824 F.2d 219, 222 (2d Cir. 1987).

Amici respectfully submit that the petition for *certiorari* should be granted in order to prevent chaos among the lower courts that are trying to define the scope and validity of the Arbitration Act.

POINT I

THE UNITED STATES ARBITRATION ACT MANDATES THAT ARBITRATION BE RECOGNIZED AS AN EFFICIENT AND WIDELY ACCEPTED MEANS OF RESOLVING BROKER-CUSTOMER DISPUTES IN THE SECURITIES INDUSTRY

The United States Arbitration Act provides that an agreement to arbitrate in a contract involving interstate commerce is valid to the same extent as any other contract. When Congress passed the Arbitration Act in 1925, it established a clear federal policy favoring the use of arbitration to resolve disputes. That policy marked a decisive shift from the hostility to arbitration then prevalent in the courts.

In its recent decisions, this Court has found occasion to recognize the policy behind the Arbitration Act. In *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, the Court observed:

> [W]e are well past the time when judicial suspicion of the desirability of arbitration and the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.

473 U.S. at 626-27. *Accord Moses H. Cone Memorial Hospital* v. *Mercury Constr. Corp.*, 460 U.S. at 24 (the Arbitration Act

"is a congressional declaration of a liberal federal policy favoring arbitration . . . [and] questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration"); *Southland Corp.* v. *Keating*, 465 U.S. at 10 (in passing the Arbitration Act, "Congress declared a national policy favoring arbitration . . . [that] mandated the enforcement of arbitration agreements"); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). *See also Wilko* v. *Swan*, 346 U.S. at 439 (Frankfurter, J., dissenting) ("[t]here is nothing in the record . . . to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled").[1]

Since this Court has decisively abandoned both the analytical reasoning and the deep suspicion of arbitration that permeates the opinion in *Wilko* v. *Swan*, there is no reason that *Wilko* should hold sway even in the narrow space to which it is now restricted. *Wilko* is premised on a fundamental hostility to arbitration. *See Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. at 2340. Proceeding from that premise, *Wilko* espoused the theory that an agreement to arbitrate Securities Act controversies waives substantive rights under that statute. Because Section 14 of the Securities Act, 15 U.S.C. § 77n, invalidates "any . . . stipulation . . . to waive compliance with any provision" of the Securities Act, and because the Court was suspicious that arbitration panels would not adequately enforce complaints with that Act, it therefore found predispute agreements to arbitrate Section 12(2) claims void.[2]

---

1 The language in *Mitsubishi*, *Moses H. Cone*, and *Southland* echoes Justice Frankfurter's dissenting language in *Wilko*, 346 U.S. at 439, rather than the majority's concern in *Wilko* that arbitration of Section 12(2) claims would endanger the "special rights" created thereby, 346 U.S. at 435.

2 *Wilko's* language shows extraordinary cynicism as to the competence of arbitration tribunals:

> [A Securities Act] case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must not only be determined but applied by the arbitrators without judicial instruction on the law. As their award may be made without expla-

The decision in *Wilko* flatly ignored the substantive federal policy embodied in the Arbitration Act. In equating an agreement to arbitrate Securities Act controversies with a waiver of compliance with that Act, *Wilko* put the blind eye to Congress's unmistakable mandate that arbitration was to be a respected method of resolving disputes and that there was no public policy against agreements to arbitrate.

As this Court has recognized, its recent decisions substantially differ from *Wilko's* hostility to arbitration. For example, *McMahon* observed:

> It is difficult to reconcile *Wilko's* mistrust of the arbitral process with this Court's subsequent decisions involving the Arbitration Act.

107 S.Ct. at 2341. Moreover, this Court has twice rejected the predicate of the *Wilko* decision, the notion that an agreement to arbitrate controversies under a federal statute waives compliance with the provisions of that statute:

> By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits their resolution to an arbitral, rather than judicial forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.

Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. at 628; *accord, Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. at 2339.[3]

> nation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as "burden of proof," "reasonable care" or "material fact" . . . cannot be examined.
>
> 346 U.S. at 435-36.

3 The fallacy in *Wilko's* confusion between a forum selection contract and a waiver of substantive rights is manifested here by the fact that

Not only did *McMahon* abandon *Wilko's* reasoning, it reached the exact opposite holding: for it held that an agreement to arbitrate claims arising under Section 10(b) of the Exchange Act was *not* a "stipulation . . . to waive compliance with" the Exchange Act, which is void under Section 29(a) of that Act, 15 U.S.C. § 78cc(a), whereas *Wilko* had held that such an agreement *was* a "stipulation . . . to waive compliance with" the Securities Act. Yet, although *McMahon* questioned *Wilko's* continuing vitality ("indeed most of the reasons given in *Wilko* have been rejected subsequently by the Court as a basis for holding claims to be nonarbitrable"), it nonetheless cautioned that "*stare decisis* concerns may counsel against upsetting *Wilko's* contrary conclusion under the Securities Act." 107 S.Ct. at 2341.

Wilko's inconsistency with the state of arbitration today in the securities industry not only explains but justifies this Court's reluctance to follow *Wilko's* holding or its policy pronouncements. The established structure of arbitration in the securities industry refutes *Wilko's* assumption that the enforcement of contracts to arbitrate securities disputes will dilute the protection of investors under the securities laws. Securities exchanges and the National Association of Securities Dealers, Inc. (the "N.A.S.D."), under the supervision of the Securities and Exchange Commission, provide arbitration facilities for disputes between member firms and their public customers.[4]

---

the plaintiffs brought this action in state court, foregoing any procedural safeguards offered by the federal courts. Since the Securities Act grants both state and federal courts jurisdiction to hear Securities Act claims, an agreement that all Securities Act claims between two parties would have to be brought in a particular state court cannot waive compliance with the Securities Act. Yet there is nothing that ensures that state courts will provide a more advantageous forum for Securities Act claims than arbitrations. To the contrary, the stock exchanges' powers to compel the presence of registered persons at arbitrations, for example, can far exceed that of state courts. *See* note 15, *infra*, at 12.

4 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. Manual (CCH) ¶ 3701; 2 N.Y.S.E. Guide (CCH) ¶ 2600 (Rule 600); Uniform Code of Arbitration § 1, *reprinted in* Fifth Report of the Securities Industry Conference on Arbitration (April 1986).

The current procedures have evolved since 1872, when the New York Stock Exchange, Inc., first adopted arbitration procedures. The N.A.S.D. has maintained arbitration facilities for more than forty years. The exchanges and the N.A.S.D. also have permanent arbitration staffs. Their rules and constitutions contain detailed codes of arbitration procedures.[5]

Moreover, the Securities and Exchange Commission has approved the implementation and operation of this arbitral system, *see* Exchange Act Release No. 16390, S.E.C. (Nov. 30, 1979), 18 S.E.C. Docket 1197 (1979), and retains jurisdiction to monitor the fairness of arbitration proceedings. *See* Section 19 of the Exchange Act, 15 U.S.C. § 78s. As the Commission itself argued to this Court in *McMahon*, in a brief signed by its General Counsel and Solicitor:

> [T]he Commission has had the power to ensure that arbitration procedures prescribed by the [Self-Regulatory Organizations] are adequate to enforce the rights of customers against brokerage firms that are members of SROs. In these circumstances, the suspicion of arbitration on which *Wilko* rested is inappropriate, and an agreement to arbitrate acccordingly should not be deemed a waiver of rights under the Exchange Act.

Shearson/American Express, Inc. v. *McMahon*, No. 86-44, Brief of the Securities and Exchange Commission as *amicus curiae* at 13.

The long established competence of securities industry arbitrators to adjudicate disputes should dispel any suspicion of the arbitral process in that industry. The stock exchanges and the N.A.S.D. keep permanent lists of arbitrators. These lists comprise senior securities industry personnel, attorneys, and other

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5 *See, e.g.*, Constitution of the New York Stock Exchange, Inc., Art VIII, 2 N.Y.S.E. Guide (CCH) ¶¶ 1351-1357; Rules 600-634 of the New York Stock Exchange, Inc., *id.* ¶¶ 2600-2634; Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., N.A.S.D. Manual (CCH) ¶¶ 3701-3743; Arbitration Rules of the American Stock Exchange, Inc., 2 Am. Stock Ex. Guide (CCH) ¶¶ 9540-9551J.

professionals from outside the industry, who are well versed in the field. *See, e.g.*, Panel of Arbitrators 1986-1987, 1 Am. Stock Ex. Guide (CCH) ¶¶ 157-59; N.A.S.D. Manual (CCH) ¶ 3702. Most have previously served as arbitrators and are therefore well acquainted with arbitration procedures and customs. Thus, this Court's observation in *Mitsubishi* that "adaptability and access to expertise are hallmarks of arbitration," 473 U.S. at 633, hits the mark with respect to the securities industry. As this Court stated after reviewing the state of arbitration in the securities industry in *McMahon*, "Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today. . . ." 107 S.Ct. at 2341.[6]

The arbitration rules of the N.A.S.D. and the various stock exchanges further ensure that arbitration practice in the securities industry will be efficient and impartial. For example, these rules require that panels of arbitrators include members of the securities industry and of the public.[7] They require a majority of "public" arbitrators (*i.e.*, unaffiliated with member firms) in disputes between public customers and member firms unless

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6 Far from considering themselves as the only tribunal capable of hearing securities disputes, the federal courts have recognized securities industry arbitrators as qualified to resolve those claims. Courts have long compelled arbitration of Exchange Act disputes between members of a securities exchange or the N.A.S.D. *See, e.g.*, *Shearson/American Express, Inc.* v. *McMahon*, 107 S.Ct. 2332; *Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 320 F. Supp. 193 (S.D.N.Y. 1970), *aff'd*, 451 F.2d 838 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.*, 287 F. Supp. 766, 772 (S.D.N.Y. 1968). Claims under the Exchange Act are routinely arbitrated if the public customer chooses to arbitrate. *See Gardner* v. *Shearson, Hammill & Co.*, 433 F.2d 367 (5th Cir. 1970) (per curiam), *cert. denied*, 401 U.S. 978 (1971); *Moran* v. *Paine, Webber, Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968); *cf. AVC Nederland B.V.* v. *Atrium Inv. Partnership*, 740 F.2d 148 (2d Cir. 1984) (affirming the dismissal of an Exchange Act claim because the parties had agreed to try all disputes in the Netherlands).

7 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9541 (Rule 601); N.A.S.D. Manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

the customer requests otherwise.[8] Arbitrators are required to disclose any business affiliation with any parties before them, and may be disqualified for cause for even the appearance of a conflict of interest.[9] Each party in an arbitration has at least one peremptory challenge.[10]

The arbitration itself proceeds much like a trial. The parties have the right to be present at the hearing, to be represented by counsel, to cross-examine witnesses, and to take a transcript of the hearing. They may subpoena witnesses and documents just as in a court proceeding, and may also compel the presence of any employee of a member of the sponsoring institution at a hearing, regardless of whether that employee would be within the subpoena power of the courts of the state where the hearing is held.[11] Moreover, arbitrators serve, and witnesses testify, under oath.[12] The fairness of these rules and procedures is borne out by the results of arbitrations conducted under them. In 1987, 55% of public customer cases that went to arbitration before one of the stock exchanges or the N.A.S.D. and were decided—rather than being settled—awarded damages to the customer.[13]

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8 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542 (Rule 602); N.A.S.D. manual (CCH) ¶ 3719; 2 N.Y.S.E. Guide (CCH) ¶ 2607 (Rule 607); Uniform Code of Arbitration § 8.

9 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9542(f) (Rule 602)(f); N.A.S.D. Manual (CCH) ¶ 3723; 2 N.Y.S.E. Guide (CCH) ¶ 2610 (Rule 610); Uniform Code of Arbitration § 11.

10 *See, e.g.*, Uniform Code of Arbitration § 10.

11 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶¶ 9546, 9548-49, 9551A (Rules 606, 608-09, 612); 2 N.Y.S.E. Guide (CCH) ¶¶ 2614-15, 2619-20, 2624 (Rules 614-15, 619-624); Uniform Code of Arbitration §§ 15-16, 20-21, 25.

12 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551B (Rule 613); 2 N.Y.S.E. Guide (CCH) ¶ 2625 (Rule 625); Uniform Code of Arbitration § 26.

13 *See* Minutes of the June 24, 1988, Meeting of the Securities Industry Conference on Arbitration, which reported arbitration statistics for 1987 similar to those previously reported to the Securities and Exchange Commission. A table of these statistics, and of the 1986 statistics compiled by the Securities Industry Conference on Arbitration, is set forth in Appendix A.

Moreover, the arbitration process significantly reduces discovery expenses and minimizes delay in reaching a hearing. *See Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. at 628; C. Katsoris, *The Arbitration of a Public Securities Dispute*, 53 Fordham L. Rev. 279, 286 (1984). For example, state laws generally provide subpoena power to arbitrators and counsel, and parties are encouraged to produce documents "to the fullest extent possible without resort to the issuance of the subpoena process."[14] Arbitrators may also direct the appearance of persons associated with member organizations or the production of records of these organizations without using the subpoena process.[15] That most stock exchanges and the N.A.S.D. offer a streamlined arbitration procedure for smaller claims also enables customers to resolve small disputes without incurring great expense.[16] Arbitration also offers an expeditious result. According to statistics compiled by the Securities Industry Conference on Arbitration, nearly 4,364 securities industry arbitrations were filed with stock exchanges and the N.A.S.D. in 1987, and 2,936 arbitrations in the securities industry were resolved during that year.[17] The 1987 figures represent more than three times the number of arbitrations filed in 1982.[18]

Finally, the excessive caseload in the federal district courts makes it all the more important that arbitrable claims between

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14 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9548 (Rule 608); N.A.S.D. Manual (CCH) ¶ 3732; 2 N.Y.S.E. Guide (CCH) ¶ 2619 (Rule 619); Uniform Code of Arbitration § 20; C. Katsoris, *supra*, at 286.

15 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9549 (Rule 609); N.A.S.D. Manual (CCH) ¶ 3733; 2 N.Y.S.E. Guide (CCH) ¶ 2620 (Rule 620); Uniform Code of Arbitration § 21.

16 *See, e.g.*, 2 Am. Stock Ex. Guide (CCH) ¶ 9551H (Rule 619); N.A.S.D. Manual (CCH) ¶ 3710; 2 N.Y.S.E. Guide (CCH) ¶ 2601 (Rule 601); Uniform Code of Arbitration § 2.

17 *See* Appendix A.

18 The number of filings rose from 1,340 in 1982 to 4,364 in 1987. *See* Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A), which is reproduced in Appendix B to this Brief.

securities firms and their customers proceed to arbitration. Filings of securities and commodities claims have increased to 2,844 in 1987.[19] Since the average caseload per United States District Judge in 1987 was 460 cases,[20] permitting agreements to arbitrate all securities laws claims would effectively create up to six new federal district judgeships, which would help to relieve the federal courts of their overloaded dockets.

Wilko thus stands bereft of any factual, legal, or policy support. *Amici* respectfully submit that *Wilko*'s defiance of congressional policy, its analytical inconsistency with this Court's more recent decisions, and its invalid factual assumptions take it out of the shelter of *stare decisis*. As the Court has long recognized, "*stare decisis*, in statutory construction, is a useful rule, not an inexorable command." *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64, 92 (1938) (Reed, J., concurring). Thus, the Court has overturned its own precedent in order to achieve consistency in interpreting statutory provisions. *See Commissioner* v. *Estate of Church*, 335 U.S. 632 (1949). The Court in *Church* reconsidered the construction of the "possession or enjoyment" clause under Section 811(c) of the Internal Revenue Code it had adopted in *May* v. *Heiner*, 281 U.S. 238 (1930). It did so because its subsequent decision in *Helvering* v. *Hallock*, 309 U.S. 106 (1940), had construed the same "possession or enjoyment" clause in Section 811(c) of the Code differently from *May*. *Church* found that the decision in *Hallock* amounted to a complete rejection of the rationale in *May*, even though it did not expressly overrule *May*. *Commissioner* v. *Estate of Church*, 335 U.S. at 643-45. While acknowledging the interests inherent in the doctrine of *stare decisis*, the Court overruled *May* in order to bring an inconsistent holding in line with its later decision. *See Commissioner* v. *Estate of Church*,

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19 Annual Report of the Director of the Administrative Office of the United States Courts, Table C2 (1987). This table is reproduced in excerpted form as Appendix C to this Brief. These figures are calculated on the basis of a year beginning July 1; "1987" statistics therefore refer to the period July 1, 1986, through June 30, 1987.

20 Administrative Office of the United States Courts, Federal Court Management Statistics 1987 at 167.

335 U.S. at 649-50. As stated in *Helvering v. Hallock*, where the Court was also confronted with incompatible decisions, the "real problem . . . is to determine whether we are to adhere to a harmonizing principle . . . or whether we are to multiply gossamer distinctions between the present cases and the . . . earlier ones." 309 U.S. at 118. Here, too, a holding that Section 12(2) claims are arbitrable would make the law with respect to those claims consistent with the law regarding Exchange Act claims.

Likewise, the Court has not hesitated to overrule decisions that "do not state the correct rule of law." *See Girouard* v. *United States*, 328 U.S. 61, 69 (1946) (overruling *United States* v. *Schwimmer*, 279 U.S. 644 (1929), *United States* v. *MacIntosh*, 283 U.S. 605 (1931), and *United States* v. *Bland*, 283 U.S. 636 (1931)). Here, again, where *Wilko*'s legal reasoning and policy consideration cannot pass muster under this Court's more recent Arbitration Act decisions, *Wilko* cannot "state the correct rule of law" and should therefore be overruled.

Last, should the Court overrule *Wilko*, it will bestow the additional policy advantage of making the law uniform for all securities law claims. Parties will have no incentive to continue to plead a Section 12(2) claim as a means of avoiding arbitration.[21] The federal court system will therefore be spared substantial motion practice over pleading matters, as well as over difficult collateral estoppel issues that invariably arise when claims arising under the same set of facts must be resolved by different tribunals.

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21 The case at bar appears to be a good example of this sort of practice. The plaintiffs originally brought a claim under the Minnesota Securities Act. When defendants moved to compel arbitration, plaintiffs amended their complaint first to add a Section 12(2) claim and then to delete their state law claim so that it could not be arbitrated. *See* Petition for a Writ of *Certiorari* at 4-5, A-15-47.

POINT II

WILKO V. *SWAN* IGNORED THE STANDARD FOR FINDING AN IMPLIED REPEAL OF THE UNITED STATES ARBITRATION ACT

By holding that Section 12(2) claims are not arbitrable on the basis of its own perception of arbitration practice, *Wilko* usurped Congress's role in setting federal policy. Specifically, while purporting to resolve a conflict between "two policies, not easily reconcilable", 346 U.S. at 438, *Wilko* in fact manufactured that conflict on the basis of its hostility to arbitration. Notwithstanding Congress's policy favoring arbitration, *Wilko* equated an agreement to arbitrate Securities Act claims with a waiver of compliance with the Securities Act in order to void such an agreement under Section 14.

Wilko's analysis stands at odds with many of this Court's rulings, in particular *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc. Mitsubishi* requires that any finding of an implied repeal of the Arbitration Act be supported by "congressional intention expressed in some other statute . . . ." 473 U.S. at 627. This is simply a reiteration of the traditional standard for finding that a federal statute has been repealed by implication by a subsequently enacted federal statute. *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. at 88 (" 'repeals by implication [of a prior statute by a subsequently enacted one] are disfavored' ") (quoting *Allen* v. *McCurry*, 449 U.S. 90, 99 (1980)); *Morton* v. *Mancari*, 417 U.S. at 550 ("In the absence of some affirmative showing of an intention [by Congress] to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable").

In *Mitsubishi*, this Court stated:

> We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

473 U.S. at 628.[22]

Under this test, there can be no question that predispute agreements to arbitrate Section 12(2) claims are enforceable under the Arbitration Act. The Securities Act contains no statutory language that restricts a party's ability to choose an arbitral forum with respect to claims brought thereunder. Section 14, on which *Wilko* relied, concerns waivers of compliance with the Securities Act, not agreements as to what forum a claim under the Securities Act may be tried before. This Court has already marked this distinction in *Mitsubishi* and *McMahon* to the extent of holding that Section 29 of the Exchange Act, a nonwaiver provision substantially identical to Section 14, did not void agreements to arbitrate in *McMahon*.

Nor is there any evidence in the legislative history of the Securities Act that Congress intended to repeal the Arbitration Act with respect to Securities Act claims. That Congress in amending the securities laws in 1975 did not act to overrule *Wilko* has no bearing on what Congress intended in 1933, the critical inquiry at bar. Nor does the fact that the Conference Report for those amendments observed that they were not intended to disturb existing law as to waiver of claims and cited *Wilko* v. *Swan*. *See* H.R. Conf. Rep. No. 94-229, at 111 (1975), *reprinted in* 1975 U.S. Code Cong. & Ad. News, at 179, 342. The Court in *McMahon* found the language quoted from that Conference Report so obscure as not to be probative of anything, with the result that "the *Wilko* issue was left to the courts." 107 S.Ct. at 2343. Moreover, such subsequent legislative inaction will not prevent a Court from revisiting a decision that was ill-founded, as *amici* respectfully suggest is the case here. For example, in *Girouard* v. *United States*, the Court overruled its prior interpretation of a statute after Congress had rejected amendments to that statute overruling the prior inter-

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22 The opinion in *Mitsubishi* cited *Wilko* v. *Swan* for this proposition, in spite of the fact that *Wilko* did not rely on text or legislative history, but rather on its hostile view of arbitration practice and its conception of an agreement to arbitrate statutory claims as a waiver of compliance with the statute in question, both of which notions *Mitsubishi* rejected in no uncertain terms.

pretation. *See* 328 U.S. at 72-76 (Stone, C. J., dissenting). As the majority held, "it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law. We do not think under the circumstances of this legislative history that we can properly place on the shoulders of Congress the burden of the Court's own error." 328 U.S. at 69-70.

Absent specific legislative evidence to the contrary, the Arbitration Act must apply to Securities Act claims and agreements to arbitrate those claims must be honored as ordinary contracts.

POINT III

THE CIRCUITS STAND IN CONFLICT AS TO THE ARBITRABILITY OF SECURITIES ACT CLAIMS

A direct conflict now exists among the Circuits with respect to whether a predispute agreement to arbitrate claims arising under the Securities Act is enforceable. On May 31, 1988, the Fifth Circuit, following this Court's analysis in *McMahon* and *Mitsubishi*, held that *Wilko* could no longer be good law after *McMahon* and that the Arbitration Act required enforcement of a predispute agreement to arbitrate where plaintiff alleged violations of Section 12(2). *Rodriguez De Quijas* v. *Shearson/American Express*, 845 F.2d 1296 (5th Cir. 1988).

Rodriguez directly conflicts with the decision of the Second Circuit in *Chang* v. *Lin*, 824 F.2d 219, 222 (2d Cir. 1987), albeit in *dictum*, that *Wilko* is still valid because it was not expressly overruled in *McMahon*.[23]

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23 A split also exists among the district courts which have considered the issue. At least four reported decisions have held that *McMahon* effectively overruled *Wilko*, thus allowing for the arbitration of claims under the Securities Act: *Ryan* v. *Liss, Tenner & Goldberg*, 683 F. Supp. 480 (D.N.J. 1988); *Kavouras* v. *Visual Products Systems, Inc.*, 680 F. Supp. 205 (W.D. Pa. 1988); *Aronson* v. *Dean Witter Reynolds, Inc.*, 675 F. Supp. 1324 (S.D. Fla. 1987); *Staiman* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 673 F. Supp. 1009 (C.D. Cal. 1987). Seven other courts have refused to overrule *Wilko*. *See Abadian* v. *Drexel Burnham Lambert*, No. 88-0186 (E.D. Pa. August 4, 1988) (LEXIS, Genfed library, Dist file); *Araim* v. *Paine Webber, Inc.*, No. 1:88-DV-73-JOT (N.D. Ga. June 21, 1988) (LEXIS, Genfed library, Dist file); *McCullogh* v. *Shearson Lehman Brothers, Inc.*, No. 86-2752 (W.D. Pa. February 18, 1988) (LEXIS, Genfed library, Dist file); *Ketchum* v. *Almahurst Bloodstock IV*, 685 F. Supp. 786 (D. Kan. 1988); *McCowan* v. *Dean Witter Reynolds, Inc.*, 682 F. Supp. 741 (S.D.N.Y. 1987); *Schultz* v. *Robinson-Humphrey/American Express, Inc.*, 666 F. Supp. 219 (M.D. Ga. 1987); *Continental Service Life & Health Ins. Co.* v. *A.G. Edwards & Sons, Inc.*, 664 F. Supp. 997 (M.D. La. 1987).

CONCLUSION

For the reasons set forth above, *amici* the Securities Industry Association, Advest, Inc., Bateman Eichler, Hill Richards Incorporated, Boettcher & Company, Inc., J.C. Bradford & Co., D.A. Davidson & Co., Incorporated, Dean Witter Reynolds Inc., A.G. Edwards & Sons, Inc., Goldman, Sachs & Co., Hambrecht & Quist Incorporated, J.J.B. Hilliard, W.L. Lyons, Inc., Johnston, Lemon & Co., Incorporated, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Piper, Jaffray & Hopwood, Incorporated, Prescott, Ball & Turben, Inc., Rauscher Pierce Refsnes, Inc., Raymond, James & Associates, Inc., Shearson Lehman Hutton Inc., and Wheat, First Securities, Inc., respectfully request that the petition for a writ of *certiorari* be granted.

Dated: September 12, 1988

Respectfully submitted,

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APPENDIX A

1987—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Of Public	Cases Carried Into 1988
American Stock Exchange, Inc.	123	72	36	26	38	24	48
Boston Stock Exchange, Inc.	0	0	0	0	0	0	0
Chicago Board Options Exchange	130	93	29	33	22	9	53
Cincinnati Stock Exchange, Inc.	0	0	0	0	0	0	0
Midwest Stock Exchange, Inc.	5	3	1	1	1	1	2

1986—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Customer Of Public	Pending
American Stock Exchange, Inc.	63	40	18	17	31	14	24
Boston Stock Exchange, Inc.	2	2	2	2	2	0	0
Chicago Board Options Exchange	72	44	16	9	12	9	28
Cincinnati Stock Exchange, Inc.	0	0	0	0	0	0	0
Midwest Stock Exchange, Inc.	4	0	1	0	0	0	6

1987—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Of Public	Cases Carried Into 1988
Municipal Securities Rule-Making Board	106	91	38	34	42	24	69
National Association of Securities Dealers, Inc.	2,886	1,625	458	325	642	364	*
New York Stock Exchange, Inc.	1,050	1,000	225	204	378	200	842
Pacific Stock Exchange, Inc.	64	52	27	11	23	13	64
Philadelphia Stock Exchange, Inc.	*	*	*	*	*	*	*
Total	4,364	2,936	814	634	1,146	635	1,078

* Figure Unavailable.

1986—ARBITRATION STATISTICS FOR SELF-REGULATORY ORGANIZATIONS AS COMPILED BY THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION

	Total Cases Received	Total Cases Concluded Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards In Favor Customer Of Public	Pending
Municipal Securities Rule-Making Board	82	68	28	20	39	15	61
National Association of Securities Dealers, Inc.	1,587	1,199	390	327	476	248	1,840
New York Stock Exchange, Inc.	965	1,004	181	205	432	210	792
Pacific Stock Exchange, Inc.	41	37	9	13	18	8	58
Philadelphia Stock Exchange, Inc.	22	15	10	6	7	2	2
Total	2,838	2,409	655	599	1,017	506	2,830

APPENDIX B

Fifth Report of the Securities Industry Conference on Arbitration Statistical Report (April 1986) (Exhibit A)

COMPOSITE ARBITRATION FIGURES

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	830	686	332	269	410	205
1981	1,042	980	306	357	532	264
1982	1,340	1,044	322	292	558	293
1983	1,731	1,259	416	320	622	331
1984	2,449	1,762	561	489	736	366
1985	2,796	2,190	664	520	961	530

AMERICAN STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	45	41	18	11	35	16
1981	39	40	7	11	42	22
1982	37	31	9	4	16	10
1983	41	42	14	8	10	6
1984	69	53	16	14	45	26
1985	64	58	21	14	41	24

Cases carried over into 1986: 29

BOSTON STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	2	2	2	2	2	0
1981	2	2	2	2	0	0
1982	1	1	1	1	1	1
1983	2	2	2	2	2	1
1984	0	0	0	0	0	0
1985	0	0	0	0	0	0

Cases carried over into 1986: 0

CHICAGO BOARD OPTIONS EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	44	31	11	11	18	6
1981	41	32	8	8	12	3
1982	50	38	6	6	14	3
1983	75	45	5	4	13	6
1984	91	56	24	16	4	3
1985	64	38	10	5	0	0

Cases carried over into 1986: 26

CINCINNATI STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	0	0	0	0	0	0
1982	0	0	0	0	0	0
1983	0	0	0	0	0	0
1984	0	0	0	0	0	0
1985	0	0	0	0	0	0

Cases carried over into 1986: 0

MIDWEST STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	2	2	1	0	1	1
1981	2	2	0	0	0	0
1982	1	0	0	0	0	0
1983	2	2	0	0	0	0
1984	1	0	0	0	0	0
1985	1	0	0	0	0	0

Cases carried over into 1986: 2

MUNICIPAL SECURITIES RULEMAKING BOARD

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	21	21	7	7	3	2
1981	25	25	5	5	7	4
1982	33	30	7	7	13	6
1983	78	39	17	9	14	5
1984	113	77	20	17	34	21
1985	91	112	31	35	54	31

Cases carried over into 1986: 60

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	318	234	134	113	122	56
1981	422	422	142	177	242	118
1982	606	435	157	139	276	140
1983	768	549	216	147	272	161
1984	1,108	747	298	244	381	196
1985	1,400	962	377	250	434	232

Cases carried over into 1986: 1,452

NEW YORK STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	367	327	131	110	221	119
1981	477	433	117	134	214	111
1982	558	473	109	113	214	118
1983	713	532	136	122	276	137
1984	1,008	796	176	183	259	113
1985	1,095	962	198	190	424	221

Cases carried over into 1986: 831

PACIFIC STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	24	28	12	11	4	3
1981	24	20	17	17	9	5
1982	31	21	15	11	10	7
1983	35	29	17	17	23	10
1984	45	26	21	11	10	7
1985	50	40	12	18	20	12

Cases carried over into 1986: 54

PHILADELPHIA STOCK EXCHANGE, INC.

	Total Cases Received	Total Cases Concluded, Including Settlements	Small Claims Received	Small Claims Concluded	Public Customer Cases Decided	Awards in Favor of Public
1980	7	0	16	4	4	2
1981	10	6	6	3	6	1
1982	23	15	18	11	14	8
1983	17	19	9	11	12	5
1984	14	7	6	4	3	0
1985	31	18	15	8	8	2

Cases carried over into 1986: 14

APPENDIX C

EXCERPTS FROM TABLE C 2.—U.S. DISTRICT COURTS CIVIL CASES COMMENCED, BY BASIS OF JURISDICTION AND NATURE OF SUIT DURING THE TWELVE MONTH PERIODS ENDED JUNE 30, 1986 AND 1987

Nature of Suit	1986	1987					
			U.S. Cases		Private Cases		
		Total	Plaintiff	Defendant	Federal Question	Diversity of Citizenship	Local Jurisdiction
Total Cases	254,838	238,982	42,653	29,369	99,301	67,071	588
Contract Actions	88,352	69,540	28,749	868	6,988	32,840	95
Real Property Actions	10,674	11,585	5,836	904	733	4,072	40
Tort Actions, Total	42,326	42,947	190	3,145	9,180	30,098	334
Personal Injury	38,248	39,146	88	2,867	8,101	27,769	321
Personal Property Damage	4,078	3,801	102	278	1,079	2,329	13
Actions Under Statutes, Total	113,392	114,836	7,876	24,449	82,383	59	69
Antitrust	877	785	21	6	758	–	–
Bankruptcy	4,561	4,701	97	67	4,537	–	–
Banks and Banking	518	520	120	77	323	–	–

EXCERPTS FROM TABLE C 2.—U.S. DISTRICT COURTS CIVIL CASES COMMENCED, BY BASIS OF JURISDICTION AND NATURE OF SUIT DURING THE TWELVE MONTH PERIODS ENDED JUNE 30, 1986 AND 1987—(Cont'd)

Nature of Suit	1986	1987					
			U.S. Cases		Private Cases		
		Total	Plaintiff	Defendant	Federal Question	Diversity of Citizenship	Local Jurisdiction
Civil Rights	20,128	19,785	668	1,775	17,342	–	–
Commerce (ICC Rates, Etc.)	922	1,063	67	7	989	–	–
Economic Stabilization Act	12	17	1	6	10	–	–
Environmental Matters	641	702	291	139	270	2	–
Deportation	199	172	–	155	17	–	–
Prisoner Petitions	33,765	37,316	12	4,507	32,779	–	18
Forfeiture and Penalty	3,480	3,493	3,345	148	–	–	–
Labor Laws	12,839	12,746	1,093	185	11,468	–	–
Protected Property Rights	5,681	5,514	20	17	5,477	–	–
Securities, Commodities, and Exchanges	3,059	3,020	165	11	2,844	–	–
Social Security Laws	14,407	13,322	81	13,241	–	–	–

EXCERPTS FROM TABLE C 2.—U.S. DISTRICT COURTS CIVIL CASES COMMENCED, BY BASIS OF JURISDICTION AND NATURE OF SUIT DURING THE TWELVE MONTH PERIODS ENDED JUNE 30, 1986 AND 1987—(Cont'd)

Nature of Suit	1986	1987					
		Total	U.S. Cases		Private Cases		
			Plaintiff	Defendant	Federal Question	Diversity of Citizenship	Local Jurisdiction
State Reapportionment Suits	10	3	–	–	3	–	–
Tax Suits	2,750	2,784	913	1,823	–	–	48
Customer Challenge	57	40	–	40	–	–	–
Freedom of Information Act	505	444	–	405	39	–	–
Constitutionality of State Statutes	336	318	5	8	302	–	3
Other Statutory Actions	8,645	8,091	977	1,832	5,225	57	–
Other Actions, Total	84	74	2	3	17	2	50
Domestic Relations	6	4	–	–	–	–	4
Insanity	–	–	–	–	–	–	–
Probate	–	–	–	–	–	–	–
Other	78	70	2	3	17	2	46